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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1974

No. 74-829

JUANITA McCLURE, [redacted],
Petitioners,

v.

FIRST NATIONAL BANK OF LUBBOCK, TEXAS, ET AL.,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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IN THE

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No. .....

JUANITA McCLURE, ET AL., *Petitioners,*

v.

FIRST NATIONAL BANK OF LUBBOCK, TEXAS, ET AL., *Respondents.*

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

Petitioners, Juanita McClure, individually and derivatively in behalf of Gaines County Developments, a Texas corporation, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on July 22, 1974. This case involves an important question of the scope of the Securities Exchange Act of 1934 which only this Court can resolve. In addition, the decision in this case is in conflict with recent decisions of other Courts of Appeals, and is in conflict with two decisions of the Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The opinion of the Court of Appeals, 497 F.2d 490, rehearing and rehearing *en banc* denied, 497 F.2d 490 (1974), appears in Appendix A following this petition. The opinion of the United States District Court for the Northern District of Texas, 352 F. Supp. 454 (1973), appears in Appendix C following this petition. Appendix D contains the recent opinion on which the Court below based its affirmance, *Bellah* v. *First National Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974).

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit was entered July 22, 1974. A timely petition for rehearing and rehearing *en banc* was denied on October 7, 1974, (Appendix B). This petition for certiorari is filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) (1970).

QUESTIONS PRESENTED

1. Whether Section 3 (a) (10) of the Securities Exchange Act of 1934, in which Congress expressly states, "the term 'security' means any note . . ." can be nullified as interpreted by the courts below to exclude a note whose payee is a national bank when that bank is sued under the Act's anti-fraud provisions by the corporate maker.

2. Whether there is a purchase or sale of a security within the meaning of the Securities Exchange Act

of 1934 when a corporation president, in conspiracy with a bank loan officer, (a) induces that corporation to issue its one-year note in return for money lent by that bank, (b) induces that corporation to assign long-term notes held by it as payee to that bank as collateral securing payment of the corporation's note, (c) secretly withdraws that money advanced by the bank from the corporate treasury, (d) issues his note to that corporation for the corporate funds he withdrew and (e) uses those corporate funds to pay his separate personal debt owed the same bank.

3. Whether the taking of a corporate promissory note by the payee national bank constitutes the purchase or sale of a security within the meaning of the Securities Exchange Act of 1934, Section 3(13), (14).

4. Whether the collateral pledge to a bank payee of common stocks owned by a shareholder in the corporation which is the maker of a note to the bank constitutes a purchase or sale of a security within the meaning of the Securities Exchange Act of 1934.

STATUTORY PROVISIONS INVOLVED

1. The Securities Exchange Act of 1934, §§ 1 *et seq.* (1970), especially Sections 3(a) (10), (13) and (14); 10(b) and 29(c). 48 Stat. 882, 891, 903; 15 U.S.C. §§ 78c(a) (10), (13)-(14); 78j(b) & 78cc(c).

Relevant sections of the statute, and Securities Exchange Commission Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1973), are set out in Appendix F.

STATEMENT OF THE CASE

This case involves fraud committed against Gaines County Developments, a Texas Corporation, and against one of its two shareholders, Juanita McClure, in the obtaining of corporate financing from the First National Bank of Lubbock, Texas. The complaint alleged that the corporation's issuance, transfer and receipt of certain promissory notes, along with a pledge of corporate stock, constituted a purchase or sale of a security under the anti-fraud provisions of the Securities Exchange Act of 1934 and Rule 10b-5.

Petitioner, Juanita McClure, who owned one-half of the outstanding capital common stock of Gaines County Developments (GCD), brought suit individually and derivatively in behalf of the corporation against its president, Adolph Hanslik, the First National Bank of Lubbock (the Bank) and Sterling Emens, Jr., the bank's loan officer (Emens). GCD was made a party defendant because of its control by Hanslik and by the bank, whom the complaint allege would not permit it to become a party plaintiff. Hanslik received a discharge in bankruptcy.

The District Court dismissed Petitioner's complaint for lack of subject matter jurisdiction, and the Court of Appeals affirmed. The opinion of the Court of Appeals glosses over as "associated transactions" (App. A, p.A-1) crucial promissory notes referred to in the Complaint (App. E.). So the following facts show the entire scheme better than the opinions of the courts below.

Following their divorce, Plaintiff and her ex-husband, Adolph Hanslik, each retained ownership of one-half of the common stock of GCD. Adolph Hanslik was at all times president and general manager, and directed the affairs of the corporation.

About August 15, 1964, Hanslik represented to Mrs. McClure that GCD business purposes required it to borrow $200,000.00 from the Bank in order to pay the corporation's business debts. (App. E., pp. A-49, 50). Hanslik represented that a substantial portion of the needed funds was to refinance monies already owed by GCD to the Bank. Respondent Emens was then and remained until approximately three years later, a vice-president and loan officer of the Bank. He was a loan officer for both Hanslik's personal business with the Bank, and the loan officer dealing with the transactions involving GCD. Emens also represented to Mrs. McClure, or her former attorney, that the $200,000.00 loan was needed for Gaines County Developents' business purposes (App. E. pp. A-50,51).

Mrs. McClure, relying upon the representations by Hanslik and Emens, executed a promissory note as secretary of GCD; Hanslik executed such note as GCD's president. The note was payable in one year to the order of the Bank (App. E. p. A-51). Through Mrs. McClure and Hanslik, GCD also executed and delivered to a trustee for the benefit of the Bank a deed of trust to secure payment of the note, mortgaging GCD's land to the Bank.

As additional collateral, the bank required Gaines County Developments to assign the Bank certain

vendor's lien notes held by the corporation in the value of at least $132,000.00, representing payment for sales of other lands of Gaines County Developments which it had sold to third persons (App. E. p. A-55). This transfer is never mentioned by the Court of Appeals.

However, GCD never had the opportunity to use the $200,000.00 for its operational purposes. Instead, on the same date that the Bank's $200,000.00 loan to GCD was deposited in GCD's account at the bank, Hanslik, with the full cooperation of Emens, withdrew such $200,000.00 and gave it back to the Bank to pay Hanslik's pre-existing $200,000.00 separate unsecured indebtedness to the Bank, which was a personal obligation of his and not an obligation of the corporation. Hanslik then executed and issued his worthless personal note payable to the order of the corporation for the funds he had diverted to his personal use. (App. E. p. A-52). Hanslik's note is mentioned once by the Court of Appeals (App. A. p. A-2), but never referred to again.

The effect of this transaction was that Hanslik's unsecured personal indebtedness to the Bank was transferred to Gaines County Developments, and the Bank ended up with a substitute note made by GCD secured by valuable lands and vendor's lien notes assigned to it by GCD as payee (App. E. p. A-52). The Court below calls all this a "commercial loan" involving only the Bank and GCD (App. A. p. A-6). To the District Court, these events were just an "ordinary commercial loan" (App. C pp. A-20, A-21, A-24).

The Bank subsequently extended GCD's one-year note, but required Mrs. McClure to pledge all of her corporate stock in GCD as additional collateral. GCD's note was not paid, and the Bank eventually foreclosed on the corporation's land and on the vendor's lien notes assigned to it by GCD, such land and notes being the corporation's only substantial assets. As recognized by the Court of Appeals, even though the Bank did not foreclose directly on the pledged stock, it became worthless when the Bank foreclosed on the mortgaged assets. (App. A. p. A-2).

REASONS FOR GRANTING THE WRIT

I.

THE UNCERTAINTY RESULTING FROM JUDICIAL NULLIFICATION OF THE CONGRESSIONAL DEFINITION OF "SECURITY" IS ACKNOWLEDGED IN THE OPINION BELOW.

The lack of clarity and conflict among decisions on promissory notes is candidly recognized by the Court of Appeals:

> Although the Securities Exchange Act of 1934 provides that the term security means "any" note, judicial decisions have restricted the applications of the Act to those notes that are investment in nature and have excluded notes which are only reflective of individual commercial transactions. The path laid down by these decisions is not entirely clear because of the difficulty in expressing in judicial opinions the characteristics of those note transactions to which the term "any

> note" does not apply. [App. A p. A-3, 497 F.2d at 492]
>
> * * *
>
> Although not all of the securities cases dealing with notes can be brought into line, analysis of the factual situations upon which the various cases were decided supports our holding that in this case the note falls outside of the purview of the Act. [App. A pp. A-4, 5, 497 F.2d at 493]
>
> * * *
>
> The original scrivener of the definitional section may well wonder what happened to his carefully drawn exemption on the way to the courthouse. . . . [App. A. p. A-9, 497 F.2d at 495].

The confusion was created however, not by Congress, but by the courts below. They have erroneously construed the phrase "unless the context otherwise requires" as a license to create their own definition of terms by looking to the context of the transaction, instead of the context of the statute. App. A, pp. A-6, n.2, A-10; App. B, p. A-18.

The definitional section of the 1934 Act, Section 3 (15 U.S.C. § 78c(a)), begins with the instruction: "When used in the chapter, unless the context otherwise requires—." The lower courts erroneously interpret this clause as a mandate to define critical terms in the context of the transaction, instead of the statute. Under such a misinterpretation of the term "context", the courts below can freely substitute their wisdom for that of Congress in defining terms.

The "context" is the context of the statute itself, according to Congressionally mandated rules of con-

struction. "In determining the meaning of any Act of Congress, unless the context indicates otherwise— . . . " 1 U.S.C. § 1 (1947). Before that codification, Rev. Stat. § 1 (1925) stated in pertinent part:

> "In determining the meaning of any Act or resolution of Congress, words importing the singular number may extend and be applied to several persons or things, . . . unless the context shows that such words were intended to be used in a more limited sense . . . "

The courts below have violated the instructions of this Court to determine the meaning of the defined term in the context of the Act itself. The term is then applied to, not defined by, the transaction. *SEC v. National Securities, Inc.*, 393 U.S. 453, 466 (1969).

II.

THE OPINIONS BELOW HOLD THAT ONLY "INVESTMENT" NOTES CAN BE A RULE 10b-5 SECURITY, BUT CONGRESS HAS DEFINED A SECURITY TO INCLUDE "ANY NOTE . . ."

A. Congress has repeatedly defined a security as "any note" a sufficient number of times to leave no doubt as to its meaning.

1. The Securities Exchange Act of 1934 clearly and unambiguously defines a security to mean "any note".

Sect. 3(10) of the 1934 Act (15 U.S.C. § 78c(10)) defines "security" thusly in pertinent part:

> (10) The term "security" means any note, stock, treasury stock, . . . any collateral-trust certifi-

> cate, . . . or any certificate of interest or participation in, . . . but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

The original note from GCD payable to the order of Defendant bank was for a term of one year, so the exemption language stated in the Congressional definition is not applicable.

2. In six other statutes Congress has deliberately defined the term "security" to mean "any note".

All of the Congressional scriveners who have defined "security" over the years may indeed wonder with great amazement about the Court of Appeals' disdain for their understanding of the English language. Not once, but seven times, in seven different statutes, Congress has defined "security" to mean "any note"

> The Securities Act of 1933, Sec. 2(1), 15 U.S.C. § 77b(1), 48 Stat. 74.
>
> The Securities Exchange Act of 1934, Sect. 3(a) 10. 15 U.S.C. § 78c(a) (10), 48 Stat. 882.
>
> The Trust Indenture Act of 1939, Sect. 303(1). 15 U.S.C. § 77ccc(1), 53 Stat. 1151.
>
> The Investment Company Act of 1940, Sect. 2(a) (36), 15 U.S.C. § 80a-2(a), 54 Stat. 790.
>
> The Investment Advisors' Act of 1940, Sect. 202 (a) (18), 15 U.S.C. § 80b-2(a) (17), 54 Stat. 847.

The Public Utility Holding Company Act of 1935, Sect. 2(a) (16). 15 U.S.C. § 79b(a) (16), 49 Stat. 804.

The National Stolen Property Act of 1948, 18 U.S.C. § 2311, 62 Stat. 805.

Such repeated use of the same definitional term by Congress is not a mere slip of the pen. Had such definition been used only once, the Court of Appeals might be on firmer ground in holding that Congress did not know what it was talking about when it used such terms. But, Congress' repeated usage of the definition precludes the judiciary from substituting its wisdom for that of Congress, in absence of a Constitutional attack on the statute, which is not present in this case.

3. Section 29(c) of the 1934 Act specifically applies to the act as loans.

Congress also displayed its intention to cover any note in the 1934 Act in the last paragraph from Sec. 29 of the Exchange Act, which specifically refers to coverage of "any loan or extension of credit . . . " The text is in App. F, p. A-59.

Virtually identical language appears in Section 26 (c) of the Public Utility Holding Company Act, 15 U.S.C. § 79z. Under it and the definitional section of that Act defining notes to be a security (§ 2(a) (16)), promissory notes issued by a utility to its parent holding company are securities and are a loan under Section 26(c) of the Public Utility Holding Company Act. *Okin v. Securities and Exchange Commission*, 154 F. 2d 27, 30-31 (2nd Cir. 1946), *cert. den.* 329 U.S. 775

(1946). The same wording and the same definitions in the Securities Exchange Act of 1934 should be interpreted in the same way.

B. Rule 10b-5 coverage of corporate debt obligations (whether notes or debentures) is a practical necessity to protect against fraud in corporate finance.

The scheme in this case has the elements of the device in *Superintendent of Insurance of the State of New York v. Bankers' Life & Casualty Company*, 404 U.S. 6 (1971). There, a corporation was deceived into selling its Treasury Bonds, with the proceeds being fraudulently used for the personal gain of the controlling stockholder. Here, GCD was deceived into assigning its securities (vendor's lien notes held by it as payee) in conjunction with issuing its promissory note, with the proceeds thereof being used for the gain of the corporate president and the Bank.

1. The substitution of GCD's note for Hanslik's note to the Bank was a fraudulent scheme to exchange a worthless investment for one of value.

The deception carried out by Hanslik and the Bank against GCD affected the corporation's decision in a way not at all unlike that involved in a merger where there is an exchange of stock for stock. This was an exchange of a note for a note. The deception resulted in corporate insolvency, not in corporate financing. Devious maneuvering cannot hide the goal of the transaction: to have GCD purchase Hanslik's note in ex-

change for its corporate note. The exchange of notes is no different here from an exchange of stock. See *SEC v. National Securities, Inc.*, 393 U.S. 453, 467 (1969).

2. The opinions below misplace the emphasis of the 1934 Act and ignore the breadth of its anti-fraud protections for the benefit of sellers and issuers, not just large numbers of purchasing investors.

The Court of Appeals regarded it as determinative that "GCD's notes were neither offered to some class of investors, nor were they acquired by the Bank for speculation or investment." (App. A p. A-6). By contrast, this Court has held that the protection of investors is merely one of the central purposes of the Act. *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

Further, " . . . the fact that the transaction is not conducted through a securities exchange or on an organized over-the-counter market is irrelevant for the coverage of § 10(b)." *Supt. of Insurance of the State of New York v. Bankers' Life and Casualty Co.*, 404 U.S. 6, 10 (1971).

The anti-fraud protections are not restricted to investors only. Rule 10b-5 also protects the issuing corporation, as well as brokerage firms, whether or not they are classified as investors. *Hooper v. Mountain States Securities Corp.*, 282 F.2d 195, 201-202 (5th Cir. 1960), *cert. den.* 365 U.S. 814 (1961) (issuing corporation); *A. T. Brod & Co. v. Perlow*, 375 F.2d 393, 396 (2nd Cir. 1967) (brokerage firm).

Even under the investor requirement, GCD was an

involuntary and defrauded investor in Hanslik's debt for the benefit of the Bank. *Zeller v. Bogue Elec. Mfg. Corp.*, 476 F.2d 795 (2nd Cir. 1973), *cert. den.* 414 U.S. 908 (1973) held that a corporation's note issued to its subsidiary was a Rule 10b-5 sale of a security, because the controlled subsidiary was at least an involuntary investor in the parent corporation.

3. That GCD received a worthless note in the exchange, instead of "investment assets," requires the application of the Acts' anti-fraud protection.

The Court of Appeals finds comfort under the reasoning that "GCD did not obtain investment assets, directly or indirectly, in exchange for its notes." (App. A p. A-8) That is true; all GCD obtained was Hanslik's worthless note, not the capital it needed. However, "Likewise irrelevant is the fact that the proceeds of the sale that were due the seller were misappropriated." *Supt. of Insurance of the State of New York v. Bankers' Life and Casualty Co.*, 404 U.S. at 10. The interpretation of the Court of Appeals implies that the statute prohibits fraudulent practices only if they fail, not if they succeed. The statute does not require such a bizarre result.

4. The lower courts' *ad hoc* distinction between "investment" notes and "commercial notes" is illusory; any bank note is by nature an investment.

The court below has created an imaginary distinction between "*investment* notes" and *commercial* notes." " . . . the Act does not cover any *commercial*

notes, no matter how long their maturity, because they fall outside the 'any note' definition of a security." App. A p. A-9. This dichotomy explains nothing when applied to the 1934 Act's anti-fraud provisions. Under it, good notes are covered, and bad ones are not.

The note issued by GCD to the Bank was an interest-bearing note. Petitioners can show that the unsecured loan by the bank to Hanslik was interest bearing. The Bank therefore expected to receive a definite return on its money, which is an investment. A national bank is not a charitable institution. It is basically an organization in the business of making profits in the form of interest charged for allowing the money under its control to be used by others.

Since the early days of the first state securities acts, that reality has been recognized. "The placing of capital or laying out of money in a way intended to secure income or profit from its employment is an 'investment' as that word is commonly used and understood." *State v. Gopher Tire & Lumber Co.*, 177 N.W. 937, 938 (Minn. 1920).

Although the term "investment" is not defined in the 1934 Act or by the courts below,

> In common parlance, it means putting out money on interest either by loans or the purchase of income-producing property." *Genessee Trustee Corp. v. Smith*, 102 F.2d 125, 127 (6th Cir. 1939).

The loans made by the Bank fell squarely within these definitions.

This court has referred to the types of real estate

loans that savings and loan associations are authorized to make as "classes of investments." *Tcherepnin v. Knight*, 389 U.S. 332 (1967) at 339, n. 21. "[I]t is immaterial whether the enterprise is speculative or non-speculative." *Id.*, 389 U.S. at 345, quoting *SEC v. W. J. Howey Co.*, 328 U.S. 293, 301 (1945).

5. The mysterious distinction between "commercial notes" and "commercial paper" injects uncertainty and confusion into legal advice and business decisions.

Bellah v. First National Bank of Hereford, 495 F. 2d 1109 (5th Cir. 1974), App. D p. A-32, was heavily relied on by the Court below, as determinative of this case. App. A, p. A-4. *Bellah v. First National Bank of Hereford*, denied Rule 10b-5 protection to a personal note issued to a bank. Bellah was an insolvent cattle feedlot operator. Yet the Court of Appeals denied Rule 10b-5 coverage under the reasoning that " . . . the note issued by the Bellahs in this case was commercial paper . . . " App. E p. A-41.

This precedent injects even more uncertainty into legal advice. Not only must we ascertain whether "any note" is a non-commercial "investment note;" we must also distinguish commercial paper from commercial paper. Yet other cases hold that even commercial paper as " . . . any note, regardless of its nature, terms, or conditions, is fully subject to whatever anti-fraud provisions are included" in the 1934 Act. *Sanders v. John Nuveen and Co.*, 463 F.2d 1075, 1078 (7th Cir. 1972), *cert. den.* 409 U.S. 1009 (1972).

C. The Court of Appeals created a preferred position for banks which nullifies the 1934 Act's protection of sellers, not just purchasers.

In *Bellah*, the Court of Appeals discerned some big difference for definitional purposes if the maker of a promissory note is a defendant, instead of plaintiff. A note to a bank is a security if the bank is plaintiff, but not if the bank is defendant. App. D p. A-37, 38, n. 3. This rationale was adopted by another panel of the Court of Appeals, relying on *Bellah. SEC v. Continental Commodities Corporation*, 497 F.2d. 516 525, n. 15 (5th Cir. 1974), decided five days before the *McClure* case.

Thus, according to the Court of Appeals for the Fifth Circuit, national banks who are lenders can now invoke Rule 10b-5 anti-fraud protections as plaintiffs, and can evade those provisions as defendants. Such holdings demolish the express protections of the 1934 Act of sellers as well as purchasers, and write a distinction into the coverage of the Act based upon the identity of the parties or their status as litigants which find absolutely no support in the 1934 Act. Sect. 10(b) protects both sellers and purchasers. 15 U.S.C. § 78j(b); *In re Caesars Palace Securities Litigation*, 360 F. Supp. 366, 391 (S.D.N.Y. 1973).

Perhaps this extreme conclusion results from the Court of Appeals' needless fear that Rule 10b-5 anti-fraud's coverage of notes to banks would require the note's registration under the 1933 Act. App. D pp. A-41, 42. That fear is groundless. The Securities Act of 1933 carefully exempts designated securities from its

registration requirements. *SEC v. Continental Tobacco Co.*, 463 F.2d 137, 155 (5th Cir. 1972). Some notes are exempt from registration, but no note is exempt from Rule 10b-5's anti-fraud coverage. *Sanders v. John Nuveen & Co.*, 463 F.2d 1075, 1078 (7th Cir. 1972), supra.

D. Congress had sufficient command of the English language to exempt bank notes from fraud coverage if it had so intended.

1. The court below erroneously presumes that Congress intended a narrow concept of security.

The court below has improperly utilized the statutory definition to restrict, rather than extend, the scope the defined term. *Warner v. Goltra*, 293 U.S. 155, 161 (1934). As this Court has said, "Section 3 (a) (10) of the 1934 Act defines 'security' very broadly . . . " *Supt. of Insurance of the State of New York v. Bankers' Life and Casualty Co.*, 404 U.S. 6, 10 (1971). "Even a casual reading of § 3(a) (10) of the 1934 Act reveals that Congress did not intend to adopt a narrow or restrictive concept of security in defining that term." *Tcherepnin v. Knight*, 389 U.S. 332, 338 (1967).

Exemptions from the coverage of the Act should be strictly construed. Instead, the court below has done the opposite: it has strictly construed the coverage, and broadly construed the exemptions. Congress could have defined "security" to include "any note—except if issued to a bank . . . " But it didn't. In departing from the literal approach, the court below now re-

quires lawyers and businessmen to seek obscure distinctions between "investment notes," "commercial paper" and "commercial notes."

The resulting confusion could be avoided by this Court's insistence again that the definitions, including "purchase or sale" must be construed broadly. *Tcherepnin v. Knight*, 389 U.S. 332, 338 (1967); *SEC v. National Securities Inc.*, 393 U.S. 453, 467 (1969). The all-encompassing definitions are within Congress' discretion, not subject to substitution by the wisdom of the lower courts. "It was both within the right and the wisdom of Congress not to trust to the colloquial or the dictionary meaning of [the term 'misbranding'] but to write its own." *62 Cases of Jam v. United States*, 340 U.S. 593, 596 (1951).

2. Legislative history shows Congressional awareness of keeping bankers honest.

What little extrinsic evidence there is does not support the preferred position given banks by the Court of Appeals. In describing the strictures of the Securities Act of 1933, the committee report included banks:

> The responsibility imposed is no more nor less than that of a trust. It is responsibility that no honest banker and no honest business man should seek to avoid or fear. HR Rep. No. 85, 73rd Cong., 1st Sess. 9.

Congress showed its awareness of banks by exempting them from other provisions of the 1934 Act. Banks are specifically excluded from the definitions of "broker" and "dealer" in §§ 3(a) (4) and (5) of the Act.

15 U.S.C. §§ 78c(a) (4) and (5). Liability predicated on a "broker or dealer concept under § 15(c)(1) of the Act, 15 U.S.C. § 78 o(c)(1)" is different from Rule 10b-5 liability, *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 154 (1972). Also Congress allowed high quality commercial notes to be exempt from the 1933 Act's registration provisions. *Sanders v. John Nuveen & Co.*, 463 F.2d 1075, 1078 (7th Cir. 1972), *cert. den.* 409 U.S. 1009 (1972). When the 1934 Act was passed, banks were the main lenders to businesses whose notes qualified as "commercial paper." Comment, The Commercial Paper Market and the Securities Acts, 39 U. of Chicago L. Rev. 362, 369, 381-385 (1972).

Respondents may oppose granting of this Writ by suggesting a conflict between the Securities Exchange Act and national banking statutes which prohibit a National bank from "dealing in securities" for its own account. 12 U.S.C. §§ 24, 377, 278. But the terms "security" and "purchase" can have a different meaning under the banking statutes than they do under the Securities Exchange Act. There is no need to "reconcile" the statutes. A bank can "sell" or "purchase securities" under the Securities Exchange Act without "dealing in securities" as that term is used in the Glass-Stegall Act. For example, a national bank can "sell" a participation in a loan made to its customers. *Lehigh Valley Trust Co. v. Central National Bank of Jacksonville*, 409 F.2d 989 (5th Cir. 1969).

Definitions of the same term (employee) can vary in one statute from the same term's definition in another. *Walling v. Portland Terminal Co.*, 330 U.S. 148,

151-152 (1946). The term " 'sale' may have a broader meaning in securities legislation than in the Internal Revenue Code." *SEC v. Sterling Precision Corp.*, 393 F.2d 217, 217 (2nd Cir. 1968).

III.

THE COURT OF APPEALS, IN SELECTIVELY RESTRICTING THE CONGRESSIONAL DEFINITION, IS IN CONFLICT WITH ITS EARLIER HOLDINGS, AND WITH DECISIONS BY OTHER COURTS OF APPEALS.

A. In *Lehigh Valley Trust Co. v. Central National Bank of Jacksonville*, 409 F.2d 989 (5th Cir., 1969), the Court of Appeals recognized that a corporate note issued to a bank in exchange for a loan of money is a security under the protection of Rule 10b-5.

In the *Lehigh* case, the corporate borrower, Larso Development Company, issued its promissory note to the Central National Bank of Jacksonville. That bank, being unable to fund all of the loan itself, issued a participation interest in the note to the plaintiff Lehigh Valley Trust Company. The corporate borrower defaulted, and the participating bank sued the originating bank under Rule 10b-5. The Court of Appeals then held that the borrower's note to the bank was a security, stating the following:

> Central Bank recognizes that the definition of a security in the Securities Exchange Act of 1934 expressly includes 'any note' and that the Larso Development Note falls within this definition. The Act provides that the term 'security' means any

> note * * * or any certificate of interest or participation in * * * any of the foregoing. 15 U.S.C.A. § 78c(a) (10). [409 F.2d at 991.]

"Any of the foregoing" specifically includes "any note." Proceeding on the obvious premise that the note from the debtor to Central Bank is a security, the Court also held that the participation agreement is a security:

> Central Bank, however, is not charged with the sale of the Larso Development note, but rather with the sale of the loan participation. This agreement *also* is clearly within the statutory definition of a security as that definition includes 'any certificate of interest or participation in * * * any of the foregoing [note, stock, etc.].' We have found no case dealing with this particular language; but in view of the Supreme Court's policy of giving a broad reading to the definition of a security, Tcherennin v. Knight, 1967, 389 U.S. 332, 338, 88 S.Ct. 548, 554, 19 L.Ed.2d 564, 570, and its generally expansive construction of the anti-fraud provisions of the Securities Exchange Act, S.E.C. v. National Securities, Inc., 1969, 393 U.S. 453, 89 S.Ct. 564, 21 L.Ed.2d 668, *we must read the statute literally* so as to include the participation agreement between Central Bank and Lehigh Trust within the security category. [409 F.2d at 992; emph. added.]

In the instant case Petitioners alleged facts showing that the scheme of Respondents and Hanslik was to pawn Hanslik's worthless note from the bank to GCD. Similarly, in *Lehigh*

> . . . Lehigh Trust showed that Central Bank ini-

> tially made poorly secured loans to Von Zamft, the financial wizard behind all of the above corporations and then tried to 'bail out' these bad loans by making new loans to new Von Zamft corporations . . . [409 F.2d at 991.]

The Court of Appeals has misapprehended and overlooked the fundamental purpose of the scheme in this case: to fraud GCD by bailing the bank out of its unsecured loan to Hanslik. This three-party aspect is not the ordinary way that banks make loans. Nothing in the opinions below distinguish the mysterious "non-commercial" characteristics of the corporate note in *Lehigh* from the corporate note in this case. The only difference between *Lehigh* and this case is that Lehigh Valley Trust Company was frauded into acquiring for only part of the corporate borrower's bad note; whereas here, GCD ended up owning all of Hanslik's worthless debt formerly owed the bank.

If corporate finance is to have any predictability when it is obtained from banks, this inconsistency between opinions by the Court of Appeals must be clarified. In *Lehigh*, the Court of Appeals followed the literal meaning of "any note" and "participation in" stated in the definitional section. The Court of Appeals erred in abandoning that forthright approach in the instant case.

B. In *Rekant v. Desser*, 425 F.2d 872 (5th Cir. 1970), the Court of Appeals held that inducing a corporation into issuing its note for grossly inadequate consideration states a Rule 10b-5 claim.

In the *Rekant* case, the corporate president, Desser,

sold his farm to that corporation and received as part payment the corporation's note. The complaint alleged that the corporation's note to its president was for inadequate consideration, because the land was not worth nearly as much as the amount of the note.

The Court of Appeals held that the issuance of the corporate promissory note was a sale of a security for the purposes of section 10(b) and Rule 10b-5. 425 F.2d at 878. In the instant case, GCD received consideration of no value, which is worse than inadequate.

C. Decisions by other Courts of Appeals applicable to this case hold that the issuance of a promissory note is a sale or purchase of a security.

Cases in conflict with the opinion below are too numerous to receive mention and full discussion in this petition. Most of them are cited by the Court of Appeals. App. A., pp. A-5 - A-8. However, four of them merit special attention.

Sanders v. John Nuveen & Co., Inc., 463 F.2d 1075, 1078 (7th Cir. 1972), *cert. den.* 409 U.S. 1009 (1972) held that "*any* note regardless of its nature, terms or conditions, is fully subject to whatever anti-fraud provisions are included in" the 1934 Act and other federal securities Acts (emphasis the court's).

Alberto-Culver Co. v. Scherk, 489 F.2d 611 (7th Cir. 1973), rev'd on other grounds ..... U.S. ....., 94 Sup.Ct. 2449, 42 U.S.L.W. 4911 (1974) held that the transfer of assets in exchange for cash and promissory notes constituted a securities transaction which in the meaning of § 10(b) Rule 10b-5 of the 1934 Act. This

Court specifically reserved decision on that holding, since Scherk did not urge the adverse ruling on that point before this Court. However, the dissent by Mr. Justice Douglas, with Mr. Justice Brennan, Mr. Justice White and Mr. Justice Marshall concurring, indicated that fraud in the issuance of promissory notes is a securities transaction covered under the 1934 Act. By granting this petition, the Court can now decide that question.

Farrell v. United States, 321 F.2d 409, 417 (9th Cir. 1963), *cert. den.* 375 U.S. 992 (1964) emphatically held that the definition of security as including "any note" is an ordinary term, which is self-defined by the Act and requires "no further definition."

S.E.C. v. Crofters Inc., 351 F. Supp. 236 (S.D. Ohio 1972), rev'd. in part *sub. nom. S.E.C. v. Coffey and King*, 493 F.2d 1304 (6th Cir. 1974) is pending in this Court under Dkt. 74-661, Petition for Writ of Certiorari filed November 27, 1974. There the Court of Appeals for the Sixth Circuit held, with reference to appellant Coffey, that the two year promissory notes issued to the Ohio Workmen's Compensation Fund and the Treasurer of Ohio were Rule 10b-5 securities. 493 F.2d 1311, 1314; 351 F. Supp. 242.

In the instant case, because Hanslik and the Bank were successful in using GCD and Mrs. McClure as dupes, Hanslik did not have to try raising his funds by obtaining a loan from an insurance company or a governmental pension fund in exchange for the corporation's promissory note. If he had, the lender would be afforded relief under the Rule 10b-5, although it

might not prevail on a non-registration claim due to the private offering exemption. In this case, there should be no distinction of the meaning of the term "security" based upon the entity giving the money, or upon the fact that here the lender participated in the fraud and is therefore a defendant, instead of a plaintiff.

IV.

THE COLLATERAL PLEDGE OF MRS. McCLURE'S COMMON STOCK WAS A PURCHASE OR SALE OF A SECURITY.

This Court has emphasized that the definitions of "purchase or sale" in § 3(a)(10) of the 1934 Act

> . . . indicate the breadth of the statutory terms by using the definitional word "include" and by including within the definitions contracts "to buy, purchase, or otherwise acquire" and "to sell or otherwise dispose of" securities. *S.E.C. v. National Securities, Inc*, 393 U.S. 453, 467 (1969).

Petitioner, Mrs. McClure, can show that the collateral pledge agreement constituted " . . . any contract to buy, purchase, or otherwise acquire" or the pledge contract was "any contract to sell or otherwise dispose of" the pledged stock shares. § 3(a) (13), (14); 15 U.S.C. § 78c(a) (13) and (14).

Mrs. McClure collaterally pledged shares of stock which on their face are a security within the meaning of the definitional section. The pledge itself was a security under the definitional section, since it could be

either a "collateral-trust certificate," or "any certificate of interest or participation in, temporary or interim certificate for . . . or right to . . . purchase . . . " the shares of stock which were pledged.

However, the Court of Appeals distinguishes the cases reported to the date of its opinion, holding that a pledge is a sale, on two grounds. First, the mere acceptance of the stocks pledged as collateral does not affect the securities industry. Second, the Bank as pledgee did not sell the pledged stock again after the pledgor defaulted. App. A, pp. A-10, 11.

The Court of Appeals' distinction may be untenable and in conflict with *S.E.C. v. Dolnick*, 501 F.2d 1279, 1282 (7th Cir., 1974). There, the defendant had pledged as collateral for a bank loan thousands of unregistered shares of corporate common stock. Nowhere is there any assertion in the opinion that the bank ever sold or foreclosed the pledged stock. The simple pledge itself was held to be a sale under the virtually identical definition in the Securities Act of 1933:

> . . . Under Section 2(3) of the Securities Act (15 U.S.C. § 77b(3)), the pledging of the stock was within the statutory definition of "sale," which includes "every * * * disposition of * * * [an] interest in a security, for value."

Dolnick involved fraud upon the pledgee bank, whereas in the present case, the fraud is upon the pledgor. Unless the preferred position of banks referred to in earlier portions of this petition is valid, neither the fact that the bank is defendant, instead of

plaintiff, nor the fact that the stock is not registered, is relevant in an action for fraud under Rule 10b-5.

The Court below is in conflict with another of its opinions announced three days before the Court denied rehearing in this case. In *Fidelity & Casualty Co. of New York v. Key Biscayne Bank*, 501 F.2d 1322, 1326 (5th Cir., 1974), a recently famous bank filed suit to recover value of stolen stock certificates, which were pledged as a collateral for a loan made by the bank, and subsequently sold by the bank to satisfy the debt. The Court of Appeals held that, under the Uniform Commercial Code, "the Bank became a 'purchaser for value' when it accepted the stock certificates as collateral." 501 F.2d at 1326. Similarly, a pledge is a disposition of an interest in a security for value under California law. *Cecil B. DeMille Production, Inc. v. Wooley*, 61 F.2d 45, 50 (9th Cir., 1932).

Only some unduly tender solicitude for banks could interpret the expansive definitions of "purchase or sale" in the 1934 Act to exclude a pledge of stock, when a pledge is a purchase under the Uniform Commercial Code. The restrictive decision of the Court below is not required by the statute.

A collateral pledge of stock is an agreement that the stock can be sold to or by the creditor if the pledgor fails to pay the related debt. Thus, it is no different from assessable stock. The Securities Exchange Commission regards a "sale" to occur whenever a stockholder makes an agreement to pay an assessment on stock. S.E.C. Rule 136, 17 C.F.R. § 230.136.

Even under the reasoning that Rule 10b-5 is to protect investors only, Mrs. McClure was an investor as a shareholder in GCD. The Bank fraudulently acquired possession and control of all of the stock of GCD under the representation that it was going to provide capital for the corporation; instead, the Bank looted the corporation. The shareholder was willing to sign an agreement (the pledge contract) with the Bank that the Bank could sell her stock if the corporation was unable to repay the loan, which was ostensibly for the purpose of protecting and improving her investment as a stockholder. Where the pledgee Bank frauds the pledgor by making misrepresentations to the pledgor concerning the actual purpose of the reason for the pledge, the shareholder's right to recover the stock back may be totally destroyed (which it was in this case) because of the pledgee's participation in misappropriating corporate funds and thereby assuring the corporation's inability to pay its note. Once having complete possession and control, not only of the assets, but also of all of the stock of GCD, Respondent Bank had full control over GCD (and Mrs. McClure's investment in it) in the same manner and extent as if the Bank had bought the stock outright. Mrs. McClure can show that her interest in GCD's stock was her principal asset. Both her right to recover her stock, and her ability to recover her stock, were totally destroyed because of the pledgee Bank's participation in the fraudulent scheme in selling GCD's assets and thereby making her stock worthless.

In the instant case, the Court below has departed from the well established doctrine that a purchase or

sale in "the strict common law traditional sense" is not required in Securities Act cases. *Dudley v. Southeast Factor and Financial Corporation*, 446 F.2d 303, 306 (5th Cir., 1971), *cert. den. sub. nom. McDaniel v. Dudley*, 404 U.S. 858 (1971). Under the particular wording of the definitional section, the collateral pledge agreement was a contract for the Bank to buy the stock itself, or to sell it to others, in event of the loan default, which eventually occurred. Compare *Manor Drug Stores v. Blue Chip Stamps*, 492 F.2d 136, 143 (9th Cir., 1973) (dissenting opinion), *cert.* granted November 11, 1974, Dkt. 74-124.

CONCLUSION

The anti-fraud protections of the Securities Exchange Act should not be subject to judicial gerrymander by nature of victim or identity of the perpetrators of the fraud. The court below, by selectively ignoring Congress' definitions, has immunized national banks, one of the major sources of corporate debt financing, from liability to corporations whose assets the bank misappropriates. The opinions below assert, but do not explain, jurisdictional distinctions between a "commercial" note and "commercial paper," and between either of them and an "investment" note. They merely invoke the litany of "commercial note" without tendering the critical explanation of why this kind of promissory note and pledge of stock are not covered by the plain wording of the Congressional definitions. In the process, they ignore the often crucial bridge between debt financing and equity financ-

ing as part of the "seamless web" of corporate finance. Granting this Petition would allow this Court to decide a question it felt was not properly before it in *Scherk v. Alberto-Culver Co.*, and thereby restore clarity and uniformity into legal advice concerning whether or not a promissory note is a security or a phantom.

For the reasons stated, petitioners pray that this Petition for Certiorari to the United States Court of Appeals for the Fifth Circuit be granted.

Respectfully submitted,

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PROOF OF SERVICE

I, Harold D. Hammett, attorney for Petitioners herein, hereby certify that on the 3rd day of January, 1975, I served the foregoing Petition for Writ of Certiorari on respondents by mailing three copies thereof in duly addressed envelopes with first class postage prepaid, addressed to their respective attorneys of record as follows:

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APPENDIX A

Juanita McCLURE, Plaintiff-Appellant,

v.

The FIRST NATIONAL BANK OF LUBBOCK, TEXAS, et al., Defendants-Appellees, Gaines County Developments, Defendant-Appellant.

No. 73-1376.

United States Court of Appeals, Fifth Circuit.

July 22, 1974.

Appeal from the United States District Court for the Northern District of Texas.

Before BELL, COLEMAN and RONEY, Circuit Judges.

RONEY, Circuit Judge:

There are two issues in this 10b-5 securities fraud case: *first*, whether the promissory note given together with a trust deed for a bank loan is a security controlled by the federal securities acts, and *second*, whether the pledge of corporate stock for renewal of the bank loan constituted a sale within the meaning of the securities law. On a motion to dismiss, the District Court held that under the allegations of fact in the complaint, neither the execution and delivery of the promissory note nor any of the associated transactions, which included the pledge of stock, constituted a sale of a security within the meaning of the Securities Exchange Act of 1934. The Court, therefore,

dismissed the complaint for lack of subject matter jurisdiction. 352 F.Supp. 454 (N.D.Tex.1973). We affirm.

The facts are fully set forth in the District Court opinion. Briefly, plaintiff Juanita Hanslik McClure was taken advantage of by her ex-husband, Adolph Hanslik, who has been discharged in bankruptcy so that any financial relief available to her must come from the First National Bank of Lubbock, Texas, and its vice-president and loan officer, Sterling Emens, Jr. The fraud theory against these two defendants is based on a $200,000 loan made by the Bank to a corporation, Gaines County Developments (GCD), which was half owned by Mrs. McClure. The stock had been divided between her and her husband in a domestic property settlement. Suing individually and derivatively on behalf of GCD, Mrs. McClure alleges that Hanslik and Emens on representations of corporate need, obtained her consent to the loan from the Bank to GCD on a one-year promissory note and a deed of trust on corporation land, but then used the $200,000 to repay unsecured personal debts of Hanslik to the Bank, rather than to pay corporate obligations. Hanslik gave his worthless personal note to the corporation for funds that he had thus diverted to his personal obligations. The Bank subsequently extended the one-year note but required Mrs. McClure to pledge her corporate stock as additional collateral. With the note unpaid, the Bank eventually foreclosed on the corporation's land, its only substantial asset, so that even though not foreclosed, the pledged stock in the corporation became essentially worthless.

Since this case comes to us for review of a dismissal of a complaint on jurisdictional grounds, we do not reach factual issues and need not concern ourselves with whether actionable fraud is alleged in the complaint either under federal securities law or under state law. Fraud is assumed for the purpose of this review. If the District Court had jurisdiction of the subject matter of the complaint, the case would have to be remanded for full development of the facts and issues surrounding these transactions. Subject matter jurisdiction must be found, if at all, under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1973). The decision as to whether the Court had subject matter jurisdiction turns on whether under the facts of this case there was a purchase or sale of a security within the meaning of the Act.

I.

The first question is whether the note given to the Bank for the loan is a security within the meaning of the Act. Although the Securities Exchange Act of 1934 provides that the term "security" means "any" note, judicial decisions have restricted the application of the Act to those notes that are investment in nature and have excluded notes which are only reflective of individual commercial transactions. The path laid down by these decisions is not entirely clear because of the difficulty in expressing in judicial opinions the characteristics of those note transactions to which the term "any note" does not apply. The authorities are reasonably consistent, however, in holding that the Act does

not cover *all* notes. A review of the decisions convinces us that the notes executed and delivered to the Bank are the kind that are not covered. Indeed, the way to this decision has been clearly indicated by a recently published opinion by Judge Walter P. Gewin, writing for another panel of this Court, which says that the reasoning of the District Judge in this case is compelling. Bellah v. First National Bank. 495 F.2d 1109 (5th Cir. 1974). We, of course, are bound only by the holding of other panels, not by the language of the opinions, but we believe that it would take *en banc* consideration for our Court now to hold that these notes are covered by the Act in the face of that decision.

In *Bellah*, the Court had under consideration a 10b-5 fraud complaint brought by two individuals against a bank which had renewed prior credit to them upon execution of a new promissory note and a deed of trust. Since the notes were of a six-month duration, the Court was considering whether the exemption in the Act of "any note . . . which has a maturity at the time of issuance of not exceeding nine months" should be applied. 15 U.S.C.A. § 78c(a)(10). Finding that judicial decisions had modified the exemption of "any" such note to exclude only so-called commercial notes, and not investment notes, the Court was compelled to determine whether the promissory note and deed of trust executed in favor of a bank for funds loaned for use in the borrowers livestock business were issued in the context of a commercial loan transaction and "beyond the purview of the Act." 495 F.2d 1114.

Although not all of the securities cases dealing with notes can be brought into line, analysis of the factual

situations upon which the various cases were decided supports our holding that in this case the note falls outside of the purview of the Act.[1] The cases excluding certain notes from the coverage of the Act generally involved underlying transactions between payor and payee which were not of an investment nature. *See* Bellah v. First National Bank, 495 F.2d 1109 (5th Cir. 1974) (renewal note for bank loan intended to aid borrowers in operation of livestock business); Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973) (note given for franchise rights); Janssen v. Tri-Pac Development Corp., Civil No. 72-1200 (E.D.Pa., Dec. 1, 1972) (note executed to purchase personal residence); Joseph v. Norman's Health Club, Inc., 336 F. Supp. 307 (E.D.Mo.1971) (promissory notes issued in return for lifetime health club memberships); City National Bank v. Vanderboom, 290 F.Supp. 502 (W. D.Ark.1968), aff'd, 442 F.2d 221 (8th Cir.), cert. denied, 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d 560 (1970) (corporate organizers gave notes for bank loans to purchase corporation's capital stock); SEC v. Fifth Avenue Coach Lines, Inc., 289 F.Supp. 3 (S.D. N.Y.1968), aff'd, 435 F.2d 510 (2d Cir. 1970) (corporate note used to satisfy one insider's personal obligations to others); *see* Beury v. Beury, 127 F.Supp. 786 (S.D.W.Va.1954), appeal dismissed, 222 F.2d 464

[1] A number of the notes cases were decided under the Securities Act of 1933, 15 U.S.C.A. § 77a et seq., rather than under Mrs. McClure's asserted jurisdictional predicate, the Securities Exchange Act of 1934. For present purposes the distinction is of little moment. In spite of occasional differences in wording, the definitions of "security" in the two Acts are functionally equivalent. *See* Tcherepnin v. Knight, 389 U.S. 332, 335-336, 88 S.Ct. 548, 19 L.Ed.2d 564 (1967). *See also* 2 L. Loss, Securities Regulation 795-796 (2d ed. 1961); 5 *id.*, 2729 (Supp. 1969).

(4th Cir. 1955) (loan made by defendant as president of one company to self as president of another; no indication whether evidenced by note).

On the other hand, whether notes have been deemed securities within the meaning of the securities laws, either of two factors, not present here, usually indicated the investment overtones of the underlying transactions.[2] First, in this case, only the Bank and GCD were involved in the execution of documents related to a commercial loan. GCD's notes were neither offered to some class of investors, nor were they acquired by the Bank for speculation or investment. *See* Sanders v. John Nuveen & Co., 463 F.2d 1075 (7th Cir.), cert. denied, 409 U.S. 1009, 93 S.Ct. 443, 34 L.Ed.2d 302 (1972) (securities broker sold short-term open market commercial paper to customers); Farrell v. United States, 321 R.2d 409 (9th Cir. 1963), cert. denied, 375 U.S. 992, 84 S.Ct. 631, 11 L.Ed.2d 478 (1964) (trust deeds and trust notes sold to general public in so-called "Secured 10% Earnings Program"); Llanos v. United States, 206 F.2d 852 (9th Cir. 1953), cert. denied, 346 U.S. 923, 74 S.Ct. 310, 98 L.Ed. 417 (1954) (promissory notes given in exchange for funds solicited for scheme to wager on "fixed" volleyball game); Hall v. Security Planning Service, Inc., 371 F.Supp. 7 (D.Ariz.1974) (development corporation sold mortgages and mortgage notes executed by land purchas-

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[2] The two factors identified here are not necessarily the only ones appropriate for consideration. *See generally* Comment, Commercial Notes and Definition of "Security" Under Securities Exchange Act of 1934: A Note is a Note is a Note?. 52 Neb.L.Rev. 478, 510-524 (1973). Each case must turn on "the complete context of each transaction." Lino v. City Invg. Co., 487 F.2d 689, 696 n. 15 (3d Cir. 1973).

ers to thousands nationwide); SEC v. Crofters, Inc., 351 F.Supp. 236 (S.D.Ohio 1972), rev'd on other grounds sub nom. SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974) (private corporation's 2-year notes purchased with State's investment funds); SEC v. Thunderbird Valley, Inc., 356 F.Supp. 184 (D.S.D.1973) (corporate notes sold to general public); United States v Hill, 298 F.Supp. 1221 (D.Conn.1969) (corporate notes sold to general public); Anderson v. Francis I. duPont & Co., 291 F.Supp. 705 (D.Minn.1968) (notes given to general public for funds to be used in a commodities trading investment pool); SEC v. Gulf Intercontinental Finance Corp., 223 F.Supp. 987 (S.D.Fla. 1963) (that notes advertised and sold to general public were securities not questioned by parties); SEC v. Addison, 194 F.Supp. 709 (N.D.Tex.1961) (notes and other securities sold to general public allegedly to finance mining operations); SEC v. Los Angeles Trust Deed & Mortgage Exchange, 186 F.Supp. 830 (S.D. Cal.), modified as to remedy, 285 F.2d 162 (9th Cir. 1960), cert. denied, 366 U.S. 919, 81 S.Ct. 1095, 6 L.Ed.2d 241 (1961) (trust deed notes sold to investors in "10% Earnings Program"); Schamber v. Aaberg, 186 F.Supp. 52 (D.Colo.1960) (stock and promissory notes payable out of production sold to investors in two states); SEC v. Vanco, Inc., 166 F.Supp. 422 (D. N.J.1958), aff'd, 283 F.2d 304 (3d Cir. 1960) (corporate notes and stock interests offered to shareholders of related publicly held corporation); *cf.* Lehigh Valley Trust Co. v. Central National Bank, 409 F.2d 989 (5th Cir. 1969) (loan participation agreement, sold by one bank to another was "certificate of participa-

tion" in note).

In the case at bar, the Bank ostensibly extended its loan so that GCD might pay off its business debt. Thus, GCD did not obtain investment assets, directly or indirectly, in exchange for its notes. *See* Rekant v. Desser, 425 F.2d 872 (5th Cir. 1970) (real estate corporation issued note and stock to obtain land for subdivision); Alberto-Culver Co. v. Scherk, 484 F.2d 611 (7th Cir. 1973), rev'd on other grounds, —— U.S. ——, 94 S.Ct. 2449, 40 L.Ed.2d —— [42 U.S.L.W. 4911 (1974)] (corporate note issued in purchase of foreign business entities); Movielab, Inc. v. Berkey Photo, Inc., 453 F.2d 662 (2d Cir. 1971) (corporation issued promissory notes in exchange for assets of film processing and optical businesses); Ingenito v. Bermec Corp., —— F.Supp. —— (S.D.N.Y.1974) (new notes containing different terms substituted for original notes given for tax sheltered cattle and cattle management contracts); Davis v. Avco Corp., 371 F.Supp. 782 (N.D.Ohio1974) (notes given for loan to be used to buy into a pyramid distribution scheme with which finance company was associated); Olympic Capital Corp. v. Newman, 276 F.Supp. 646 (C.D.Cal.1967) (that note evidencing debt to small business investment company was security not questioned by parties); *cf.* MacAndrews & Forbes Co. v. American Barmag Corp., 339 F.Supp. 1401 (D.S.C.1972) (bills of exchange issued for industrial machinery a form of notes subject to the Act.)[3]

[3] Four cases do not fit easily into the foregoing classification of cases. *See* Zeller v. Bogue Elec. Mfg. Corp., 476 F.2d 795 (2d Cir., cert. denied, 414 U.S. 908, 94 S.Ct. 217, 38 L.Ed.2d 146 (1973) (corporation's note issued to evidence open account indebtedness to partly

We realize that our holding today that the Act does not apply to commercial notes of a longer duration than nine months, taken with the decisions voiding the short-term exemption as to investment paper, virtually writes that exemption out of the law. On one hand, the Act covers all *investment* notes, no matter how short their maturity, because they are not encompassed by the "any note" language of the exemption. On the other hand, the Act does not cover any *commercial* notes, no matter how long their maturity, because they fall outside the "any note" definition of a security. Thus, the investment or commercial nature of a note entirely controls the applicability of the Act, depriving of all utility the exemption based on maturity-length. The original scrivener of the definitional section may well wonder what happened to his carefully drawn exemption on the way to the courthouse, but if the judicial decisions do not properly reflect the intent of Congress as to the coverage of the Act, only that body can properly rectify the situation at this point, if stare decisis is to apply and the Supreme Court does not make some definitive decision contrary to the presently decided cases.

owned subsidiary); Young v. Seaboard Corp., 360 F.Supp. 490 (D.Utah 1973) (defendant's caused bank to collapse by inducing it to make uncollectible loans for which notes were given); Prentice v. Hsu, 280 F.Supp. 384 (S.D.N.Y. 1968) (defendant's notes exchanged for advances for expenses of retrieving assets to be invested in plaintiff's corporation); Whitlow & Assocs. v. Intermountain Brokers, Inc., 252 F.Supp. 943 (D.Haw. 1966) (deposit with unsuccessful application for loan commitment "in connection with" sale of security). In *Zeller*, the Second Circuit accepted the distinction between commercial and investment notes but held that the controlled subsidiary stood in the position of an at least involuntary investor in the parent as the result of the advances the parent had caused it to make. 476 F.2d at 800.

II.

Mrs. McClure's second argument is that her pledge of her stock in consideration for the Bank's renewal of the GCD loan was a "sale of any security" protected by the anti-fraud provisions of section 10(b) of the Securities Exchange Act and SEC Rule 10b-5. We do not doubt that a pledge of securities can constitute a "sale" in some cases, but we hold that the pledge was not a sale in the circumstances of this case.

The securities acts have as their fundamental purpose the protection of investors. To this end they are designed to "substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus achieve a high standard of business ethics in the securities industry." Affiliated Ute Citizens v. United States, 406 U.S. 128, 151, 92 S.Ct. 1456, 1471, 31 L.Ed.2d 741 (1972), quoting SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186, 84 S.Ct. 275, 11 L.Ed.2d 237 (1963). A commercial bank in accepting a pledge of stock as additional consideration for the extension of an overdue commercial loan does not necessarily affect the securities industry. A commercial bank's business is lending money not trading in securities. *Cf.* Bronner v. Goldman, 361 F.2d 759 (1st Cir.), cert. denied, 385 U.S. 933, 87 S.Ct. 295, 17 L.Ed.2d 214 (1966) (factor selling pledged stock not a "broker" or "dealer"). If the bank sells stock pledged as loan collateral, it might then be subjected to liability in connection with the sale if it does not meet the requirements of the anti-fraud provisions of the securities acts, but mere acceptance of a stock pledge as collateral in a privately negotiated transaction between borrow-

er and lender does not, of itself, bring within the scope of the federal securities acts a transaction otherwise outside their purview. *See* 1 L. Loss, Securities Regulation 649 (2d ed. 1961).

The cases relied upon by Mrs. McClure, SEC v. Guild Films Co., 279 F.2d 485 (2d Cir.), cert. denied, 364 U.S. 819, 81 S.Ct. 52, 5 L.Ed.2d 49 (1960); SEC v. Pig'n Whistle Corp., 359 F.Supp. 219 (N.D.Ill. 1973); SEC v. National Bankers Life Insurance Co., 334 F.Supp. 444 (N.D.Tex.1971), aff'd, 477 F.2d 920 (5th Cir. 1973); and American Bank & Trust Co. v. Joste, 323 F.Supp. 843 (W.D.La.1970), do not mandate a contrary conclusion. Except for *Joste*, these cases involved the question of whether a pledge of unregistered stock is a sale for purposes of section 5 of the Securities Act of 1933, 15 U.S.C.A. § 77e. In the framework of that section, the pledge of unregistered stock as loan collateral is a "sale" because it causes the bank to become an "underwriter" when it forecloses and sells the unregistered securities. SEC v. National Bankers Life Insurance Co., 324 F.Supp. 189, 194 (N.D.Tex.), aff'd mem., 448 F.2d 652 (5th Cir. 1971). *See also* 1 L Loss, Securities Regulation 645-651 (2d ed. 1961). In this context, it is significant that, unlike the case at bar, each of the section 5 cases involved sale of the pledged stock by the pledgee after the pledgor defaulted. *Joste*, too, although an action brought under an anti-fraud provision of the 1933 Act, 15 U.S.C.A. § 77*l*, is distinguishable on the ground that the bank therein sold the pledged stock upon default. On the other hand, in this case the Bank did not foreclose on Mrs. McClure's pledged stock and did not

sell it. Title to it remains in Mrs. McClure. Under these circumstances, her pledge did not constitute a "sale" of her stock within the meaning of section 10(b) of the 1934 Act and of Rule 10b-5. *Cf.* Herpich v. Wallace, 430 F.2d 792, 812 (5th Cir. 1970) (guarantor of pledgor not "purchaser" of pledged stock where *inter alia* no allegation of foreclosure).

Affirmed.

APPENDIX B

UNITED STATES COURT OF APPEALS

FIFTH CIRCUIT
OFFICE OF THE CLERK

EDWARD W. WADSWORTH
CLERK

600 CAMP STREET
NEW ORLEANS, LA. 70130

October 7, 1974

TO ALL COUNSEL OF RECORD

Re: No. 73-1376 McCLURE V. THE FIRST NATIONAL BANK OF LUBBOCK, TEXAS

Dear Counsel:

This is to advise that an order has this day been entered denying the petition( ) for rehearing, and no member of the panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the petition( ) for rehearing en banc has also been denied.

See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,
EDWARD W. WADSWORTH
CLERK
By /s/ Anne G. Parent
Deputy Clerk

cc: Mr. Harold D. Hammett
Mr. James H. Milam
Mr. Michael R. Waller
Mr. Thomas Jefferson Griffith

APPENDIX C

Juanita McCLURE, Plaintiff,

v.

The FIRST NATIONAL BANK OF LUBBOCK, TEXAS, et al., Defendants.

Civ. A. No. 5-1018.

United States District Court,
N.D. Texas,
Lubbock Division.

Jan. 11, 1973.

MEMORANDUM AND ORDER

WOODWARD, District Judge.

The instant case is before the Court on motion of defendants to dismiss for failure to state a cause of action. The complaint against defendant Adolph R. Hanslik has heretofore been dismissed for the reason that said defendant was previously discharged in bankruptcy.

Plaintiff alleges jurisdiction under 15 U.S.C. §§ 78a-78u, being a portion of the Securities Exchange Act of 1934. All parties are Texas residents.

For purposes of this motion to dismiss, the Court must accept all of plaintiff's allegations as true in determining whether any of the facts alleged could conceivably constitute a cause of action under the Securities Exchange Act of 1934. The Court will limit

its consideration of the motion to dismiss to the question of whether the transactions alleged in the complaint constitute a "purchase or sale of any security" within the meaning of 15 U.S.C. § 78j(b).

In general, the Court is here presented with the question of whether the execution of promissory notes, and the fraudulent misapplication of funds obtained thereby, is or can be actionable under the Securities and Exchange Act of 1934. In the instant case, the transactions are actionable under such Act only if those transactions constitute the "purchase or sale of any security."

In alleging defendants' liability under the Act, plaintiff complains in summary as follows: As part of a property agreement pursuant to divorce, plaintiff and defendant (formerly husband and wife) each retained ownership of one-half of the common stock of Gaines County Developments (GCD), a Texas corporation. Defendant Adolph Hanslik was at all material times general manager, or directed the affairs, of GCD without consultation with plaintiff.

On or about August 15, 1964, defendant Hanslik represented to plaintiff that GCD needed to borrow $200,000 from defendant First National Bank of Lubbock (the Bank) in order to pay said corporation's business debts, a substantial portion of which such defendants alleged were owed by GCD to the Bank. Defendant Sterling Emens, Jr., was then and until approximately August 31, 1967, a vice-president and loan officer of the Bank. Emens also represented to plaintiff that the $200,000 loan was needed for GCD's business debts.

Plaintiff, relying upon defendants' representations, executed a promissory note as secretary of GCD; defendant Hanslik also executed such note as president, dated on or about August 15, 1964, payable to the order of the Bank. GCD, purportedly acting through plaintiff and defendant Hanslik, also executed and delivered to A. D. Justice, trustee for the benefit of the Bank, a deed of trust to secure payment of the note. This deed of trust mortgaged to the Bank a parcel of land constituting of substantially all the assets of GCD. This transaction was consummated on or about September 4, 1964, by the deposit of $200,000 in the GCD account at the Bank pursuant to the note payable on or before August 13, 1965.

Plaintiff further alleges that through fraud and conspiracy between and among defendants, the $200,000 was never intended to be, and was never, applied to the debts of GCD. Rather, said funds were applied, with the full knowledge of defendants, to payment of a pre-existing unsecured debt owed by defendant Hanslik to the Bank. Said unsecured debt had been incurred by defendant Hanslik on or about August 3, 1964, at a time when defendant Hanslik already owed the Bank approximately $700,675.

On the same date that the $200,000 loan to GCD was deposited in GCD's account at the Bank, defendants used this $200,000 to pay off the pre-existing $200,000 unsecured indebtedness which defendant Hanslik had incurred on or about August 3, 1964. Then defendant Hanslik, under date of September 3, 1964, and unknown to plaintiff, executed a personal promissory note in the amount of $200,000 payable to

the order of GCD.

On or about April 4, 1967, plaintiff executed a purported separate collateral agreement pledging to the Bank a portion of her stock in GCD and in Gaines Farm and Ranch Corporation for the purpose of securing a new note for $202,300.16 renewing and extending the original note of $200,000 made by GCD. A new deed of trust was executed pursuant to this collateral agreement. On or about September 3, 1968, after the Bank had instituted foreclosure proceedings, trustee A. D. Justice purportedly sold all the Gaines County property of GCD to the Bank for $125,000.

Plaintiff contends that the notes, deeds of trust and other instruments and agreements above referred to are securities and that each defendant, by the use of means or instrumentalities of interstate commerce or of the mails, employed or used manipulative or deceptive devices in connection with the purchase or sale of such securities. Said acts of defendants are allegedly in violation of Section 10(b) of the Securities and Exchange Act of 1934 (the Act), 15 U.S.C. § 78j(b), and of Rule 10b-5, 17 C.F.R. § 240.10b-5, adopted pursuant thereto. Plaintiff alleges actual monetary damages and claims exemplary damages as a result of such transactions.

The Court must first determine whether the notes or other instruments above described constitute "securities" within the meaning of the Act. The Act provides in 15 U.S.C. § 78c(a)(10) that unless the context otherwise requires, "The term 'security' means any note . . . but shall not include . . . any note . . .

which has a maturity at the time of issuance of not exceeding nine months . . . " The courts have not given this section an absolutely literal interpretation, for to do so would be to place under the coverage of the Act many day-to-day loan transactions unrelated to the fraud-related abuses which Congress in 1934 was attempting to correct and regulate. Beury v. Beury, 127 F.Supp. 786, 789 (S.D.W.Va.1954). Nevertheless, most federal courts including the Fifth Circuit Court of Appeals have construed the statute broadly enough so that "*almost* all notes are held to be securities" (emphasis added). Lehigh Valley Trust Co. v. Central National Bank of Jacksonville, 409 F.2d 989, 992 (5th Cir. 1969).

The obvious logical deduction from such statement is that there are some notes which do not constitute "securities" under the Act. Accordingly, the court in Joseph v. Norman's Health Club, Inc., 336 F.Supp. 307, 313 (E.D.Mo.1971), held that certain promissory notes were not securities. In *Joseph*, plaintiffs purchased lifetime memberships in defendant health club and gave promissory notes in payment for said memberships. The court held that the context of the transactions placed them outside the purview of the Act, since the statute defines a note as a security "unless the context otherwise requires."

The *Joseph* court relied heavily upon City National Bank of Fort Smith, Arkansas v. Vanderboom, 422 F.2d 221 (8th Cir. 1970). There, as in the instant case, fraud was charged against a bank for alleged misrepresentations to the makers of certain notes. The court held that the bank did not sell or offer to sell any

security of any kind to the "investors" but merely loaned them some money with which to purchase stock. In determining the scope of the "in connection with the purchase or sale of any security" clause, the court explained that

> It is apparent that the extent of the coverage and liability imposed under Section 10(b) of the Securities and Exchange Act and Rule 10b-5 has not as yet been defined . . . [T]he statutory section and the rule constitute one of several broad anti-fraud provisions set forth in the securities law in which application of the 'allegedly proscribed conduct must have been "in connection with the purchase or sale of any security." *The relevant definitional sections of the 1934 Act are for the most part unhelpful* * * *. Consequently. we must ask whether respondents' alleged conduct is of the type of fraudulent behavior which was meant to be forbidden by the statute and the rule.' [SEC v. National Securities, Inc., 393 U.S. 453, 466-467. 89 S.Ct. 564, 21 L.Ed.2d 668 (1969)] (emphasis added)

City National Bank of Fort Smith, Arkansas v. Vanderboom, 422 F.2d at 229. Other portions of the *Vanderboom* opinion have been cited with approval by the Fifth Circuit Court of Appeals in Clement A. Evans & Co. v. McAlpine, 434 F.2d 100, 103 (5th Cir. 1970).

A similarly helpful discussion of the "security" definition in the statute was undertaken by the United States Supreme Court, which found liability under the Act in SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 64 S.Ct. 120, 88 L.Ed 88 (1943):

> However well [some rules of statutory construc-

> tion] may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with *its dominating general purpose*, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out *in particular cases* the generally expressed legislative policy. (emphasis added)

Id. 320 U.S. at 350-351. Significantly, the Court states that the term "security" is defined in the Act "to include by name or description many documents in which there is *common trading for speculation or investment*" (emphasis added). *Id.* at 351. This Court agrees that the Act was designed primarily and almost exclusively to curb abuses involved in "trading for speculation or investment." Thus the Act is designed to deal with substance over form and to regulate and prohibit fraud involved in the sale of promissory notes where such notes are sold or traded for purposes of speculation or investment in the same way that stock, bonds, or debentures might be traded, sold, or exchanged. Such an interpretation of the "any note" provision of the statute is consistent with the "dominating general purpose" of the Act and specifically of 15 U.S.C. § 78j(b).

This Court holds, however, that the definition of "security" in the Act is not intended to include any of the instruments or transactions pertinent to the present case. Rather, this Court holds that the transactions involved amount to little more than ordinary commercial loans not intended to be covered by the Act. These

transactions are totally unrelated to the abuses involving "trading for speculation or investment," which abuses Congress in 1934 sought to eliminate.

It is significant that Congress has in effect found, by passage of the Truth in Lending Act, 15 U.S.C. § 1601 et seq., that the Securities Exchange Act of 1934 is inapplicable to consumer loans and, by strong implication, to commercial loans as well. Congress apparently felt it necessary to curb abuses in consumer loans by the passage of a new statute, thus implying that such abuses could not be reached by the Securities Exchange Act of 1934. And in 15 U.S.C. § 1603, a section within the Truth in Lending Act, Congress in setting forth transactions *outside* the purview of the Truth in Lending Act lists "credit transactions . . . for business or commercial purposes" and "transactions in securities" as *two different types of transaction.* Thus it is clear that most, if not all, ordinary commercial loans are not "securities" as defined by Congress as recently as 1968. Should Congress wish to place such commercial loans under federal regulation, it need only enact a statute similar in form to the Truth in Lending Act. It is not within the proper province of this Court to extend the scope of the Securities Exchange Act of 1934 beyond the point where Congress has chosen to act.

The transactions alleged by plaintiff are therefore matters of internal corporate management, are simple private loan transactions, and do not involve a subterfuge for stock transactions where adherence to substance over form would demand coverage by the Act. Rather, the actions complained of are actionable,

if at all, under state laws regarding fraud or violations of corporate fiduciary obligations. The Court intimates no opinion as to such possible liability outside the Act.

Thus these particular notes and transactions are not "securities" within the meaning of the Act. But even if these instruments complained of are securities, the transactions complained of must constitute the "purchase or sale" of such securities in order for liability to exist under the Act and in order for this Court to have jurisdiction over the present complaint. The Court holds that these transactions do not constitute the "purchase or sale" of securities and that for this additional reason plaintiff has not a cause of action under federal law.

Plaintiff cites Rekant v. Desser, 425 F.2d 872 (5th Cir. 1970), in support of its positions including its contention that the issuance of a note by a corporation to an officer or stockholder constitutes the sale of a security. On their face, the facts in *Rekant* are somewhat similar or analogous to those in the instant case. *Rekant* is an action by a minor stockholder against the president, a director of the corporation. Defendant owned a parcel of land which he made available as collateral to secure an indebtedness incurred by the corporation. Subsequently defendant sold that property to the corporation and received instead of cash an unsecured note issued by the corporation. Plaintiff alleged that the land was worth much less than the face amount of the loan. Plaintiff also complained that the note was repeatedly reduced whenever the corporation received substantial cash, thus causing a

continuing operating loss and shortage of working capital. The court held that jurisdiction existed under the Act.

The courts have failed to draw a clearly discernible line of demarcation in limiting or defining the scope of section 78j(b). The factual differences between the circumstances in *Rekant* and those in the present case provide a convenient and necessary opportunity to draw a distinction between transactions which are prohibited by the Act and those which are not. The key to this distinction lies in the laudable observation by the *Rekant* court that "That World-Wide may have chosen to pay for the land by the issuance of its note as opposed to the issuance of some other form of security should have no bearing on the coverage of [Rule 10b-5]." 425 F.2d at 878. Thus where the transaction complained of is one where the issuance of a note rather than of shares of stock is merely a technical difference in form, since defendant in exchange for the land could have taken an instrument more usually thought of as a security (such as additional shares of stock), there is jurisdiction under the Act.

Thus the major purpose of the section is to protect the investor, who is a purchaser of a security, from fraud and misrepresentation. This purpose is properly recognized by the *Rekant* court:

> As used in the Exchange Act, the term 'security' 'embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.' Tcherepnin v. Knight, 1967,

389 U.S. 332, 338, 88 S.Ct. 548, 554, 19 L.Ed.2d 564, 570 . . .

The defendant in *Rekant* fit this description precisely since he represented to his stockholders that he was giving the corporation valuable land which it could subdivide and from which it could reap great profit.

The present fact situation is not one into which a sale of stock could be so easily inserted in place of the transactions alleged. The initial note executed by plaintiff and defendant Hanslik did not constitute an investment by the Bank and was by no means a subterfuge for a stock transaction. Rather, the initial $200,000 note secured by the deed of trust was used largely to pay off other unsecured indebtedness to the Bank. The transaction was an ordinary commercial loan essentially unlike a stock investment. Surely plaintiff would not contend that the Bank would have or could have invested in GCD by giving $200,000 in exchange for stock of GCD or that the note transaction was merely a subterfuge for a stock transaction, a "[scheme] devised by those who seek the use of the money of others on the promise of profits." 389 U.S. at 338. This is not necessarily to say that plaintiff was not defrauded or cheated in the execution of the note, but merely that the transaction does not point to liability under the Act consistent with Congressional intent.

Likewise, the other transactions complained of by plaintiff fall on that side of the line of demarcation which constitutes the category of ordinary commercial loan transactions unrelated to securities regulation.

The deed of trust served merely as collateral for the ordinary commercial bank loan and does not amount to the "sale" of any property or security. The application of the proceeds of the $200,000 loan to the individual indebtedness of defendant Hanslik may have deprived the corporation of property to which it was legally entitled but was at most an act of fraud and a breach of defendant Hanslik's fiduciary duty, not the sale of a security actionable under the Act. The note for $200,000 given by defendant Hanslik to the corporation was likewise an ordinary loan, not analogous to an investment or stock transaction. This note was the *quid pro quo* for the $200,000 proceeds received by Hanslik from the corporation and applied to his separate debts. If the initial note endorsed by plaintiff did not constitute the sale of a security, neither could the separate collateral agreement of April 4, 1967, which merely renewed and extended the original note, be actionable under the Act. And finally, the foreclosure proceedings were ordinary commercial proceedings pursuant to the loan collateral agreement and are not transactions covered by the Act.

In *Rekant*, defendant used an allegedly fraudulent device—a note in an excessive amount—in causing or inducing a corporation to invest in a parcel of land. The transactions involved were not commercial loans in any ordinary sense. The fact that defendant received a note rather than stock or some other instrument more widely recognized as a security should not and does not relieve him of liabilty under the Act. Defendant Hanslik in the present case, however, contrived no substitute or formal equivalent to a stock or

investment transaction. He merely induced a person with whom he shared half ownership in a closely-held corporation, the sole substantial asset of which was a parcel of land, to execute various notes and accompanying instruments as part of an ordinary commercial loan arrangement. Clearly Congress in 1934 did not intend such a scheme or arrangement to be actionable under the Act, which is designed primarily to protect public and private investors in the sale of stock and other securities.

This Court concurs with the district court in *Rekant* which asserted that "the plaintiff does not have a cause of action under Rule 10(b)(5) in that internal corporate matters or mishandling of corporate transactions is not within the purview of this Rule" (quoted in 425 F.2d at 876). The Court of Appeals does not reject this sound contention but instead properly bases its decision upon other grounds.

This Court is aware that the issuance of its own stock by a corporation constitutes the "sale" of that stock and hence the sale of a security under section 78j(b). Hooper v. Mountain States Securities Corporation, 282 F.2d 195 (5th Cir. 1960); Movielab, Inc. v. Berkey Photo, Inc., 452 F.2d 662 (2d Cir. 1971). By this same reasoning, the issuance of a note which is the formal equivalent of the issuance of shares of stock would be covered by the Act. SEC v. Vanco, Inc., 166 F.Supp. 422 (D.N.J.1958), aff'd, 283 F.2d 304 (3d Cir. 1960). This Court rejects the proposition, however, that the issuance of a note in an ordinary commercial loan transaction constitutes the "sale" of such

note according to the intent of Congress under the Act.

In *Movielab, supra*, plaintiff corporation issued notes to defendant corporation (both corporations being publicly held) for $10,500,000, payable over a period of 20 years, in exchange for the assets of defendant corporation. Reading the Act "flexibly, not technically and restrictively," 452 F.2d at 663, the court held that it had jurisdiction under the Act. However, *Movielab* is clearly distinguishable from the instant fact situation in that the *Movielab* transaction was the formal equivalent of the common merger acquistion whereby Corporation A purchases the assets of Corporation B and issues its own stock in payment. In *Movielab*, Corporation A merely issued a note in place of its stock. The *Movielab* court refused to rule that in a different context the issuance of a corporate note would not be outside the coverage of the Act:

> [A]ppellants strenuously urge that claims of fraud in connection with the issuance of notes in every *private loan transaction* cannot be within the scope of [the Act]. Otherwise, they say, federal jurisdiction could be invoked in connection with the issuance of any check or note no matter how small the transaction so long as some instrumentality of interstate commerce was used. *We do not deal with that hypothetical situation.* (emphasis added)

452 F.2d at 663. The court adds that the Act states that " 'The term "security" means any note . . . ' and therefore includes *some* notes at the very least." *Id.* at 663. Further, the trial court in *Movielab* supported its position by stating that "it must be conceded that

notes of the type issued here are frequently discounted, purchased for investment, hypothecated, or otherwise made the subject of dealings in the market place." 321 F.Supp. 806, 809. Clearly the notes involved in the instant case are not notes of such a type that would be traded on the open market.

The trial court in *Movielab* dismisses unpersuasively the opinion in SEC v. Fifth Avenue Coach Lines, 289 F.Supp. 3 (S.D.N.Y.1968), aff'd, 435 F.2d 510 (2d Cir. 1970), on the basis that *Fifth Avenue* involved a "personal loan" rather than a "note." This Court finds such a distinction totally inapplicable and irrevelant. The facts in *Fifth Avenue* are in many ways very similar to those in the present case. The transactions complained of involved numerous loans involving excessive charges and fraudulent diversions of funds. The court found that

> . . . there was a note from Gray Line to Morrill. But Krock and Muscat did not 'sell' this note to Fifth, nor did Fifth 'purchase' it, in any normal sense of those words. The loan went to Gray Line because it was Gray Line which was indebted to Hertz. Gray Line did not have any money. Fifth eventually did. Hence, Krock and Muscat caused Fifth to pay Gray Line's loan, plus a premium of $107,000 in the bargain. *This is overreaching on an indivdual loan transaction, but it is not fraud in the purchase or sale of securities* within the meaning of the two Acts. (emphasis added)

289 F.Supp. at 38. *Accord*, Gordon v. Lipoff, 320 F. Supp. 905, 913 (W.D.Mo.1970).

An excellent example of a case where a promissory

note transaction should be and is covered by the Act is SEC v. Addison, 194 F.Supp. 709 (N.D.Tex.1961). There, "defendants needed money to get into operation and . . . in order to finance such operations, they were soliciting unconditional unsecured loans of money from members of the general public." *Id.* at 715. Such defrauding of public investors is precisely within the purview of the Act. No such situation is present in the instant case.

Plaintiff cites United States v. Austin, 462 F.2d 724 (10th Cir. 1972), in support of its position. This case is not persuasive, however, in the present text, since *Austin* deals with a letter of commitment which was sold by defendant. The court does not deal directly with the question of whether an ordinary commercial loan is covered by the Act.

Plaintiff likewise relies on Sanders v. John Nuveen & Co., 463 F.2d 1075 (7th Cir. 1972). However, the court emphasizes the fact that the commercial paper involved in *Sanders* "was therefore obviously offered and sold to the general public; indeed, it was characterized in the issuer's financial statements as 'short term open market' paper." *Id.* at 1079. The *Sanders* court suggests indirectly that *all* notes having a maturity of more than nine months can be reached by the Act. With such reasoning this Court disagrees. *Sanders* does provide, however, a useful and cogent distinction between two different kinds of notes: commercial (not covered by the Act, in the view of this Court) and investment (covered by the Act). The former is created "when a prospective borrower ap-

proaches a bank for a loan and gives his note in consideration for it." The latter is created when a person "seeks to invest his money and receives a note in return for it." *Id.* at 1080. This Court holds that all notes in the latter category, regardless of maturity, are under the Act and that no notes in the *former* category having a maturity not exceeding nine months are under the Act. The instant case involves notes in the former category with maturity *greater* than nine months. In such a circumstance, this Court holds that jurisdiction under the Act must be determined by looking at the particular instruments involved in light of Congressional intent. After doing so, this Court concludes that the instant case must be dismissed.

Finally, the Court is aware of Superintendent of Insurance of New York v. Bankers Life & Casualty Co., 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971), finding jurisdiction under the Act in the case of a sale of bonds. But the Court explicitly refused to determine whether transactions involving misuse of certificates of deposit could be reached by the Act. 404 U.S. at 13 n. 10. And the Court emphasized that "We agree that Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement." *Id.* at 12.

Since the present case involves no more than ordinary and conventional commercial notes and accompanying documents, and since the complaint alleges in effect no more than corporate mismanagement, this Court concludes that the acts and omissions complained of, however fraudulent or otherwise actionable, do not

confer jurisdiction upon this Court under the Securities and Exchange Act of 1934. Accordingly, the Court will enter an order of even date herewith dismissing the present cause of action for lack of jurisdiction, with prejudice as to said Act but without prejudice as to any future complaints based upon alternate theories of law upon which this Court passes no judgment.

APPENDIX D

J. C. BELLAH and wife Fern Bellah,
Plaintiffs-Appellants,

v.

The FIRST NATIONAL BANK OF HEREFORD,
Hereford, TEXAS, Defendant-Appellee.

No. 73-2867.

United States Court of Appeals,
Fifth Circuit.

June 14, 1974.

Appeal from the United States District Court for the Northern District of Texas.

Before GEWIN, THORNBERRY and SIMPSON, Circuit Judges.

GEWIN, Circuit Judge:

J. C. and Fern Bellah (the Bellahs) husband and wife, appeal from a district court order dismissing their complaint alleging that the First National Bank of Hereford (the Bank) had committed violations of 15 U.S.C. § 78j(b) (1970) and Rule 10b-5 promulgated pursuant thereto.[1] Jurisdiction under the aforemen-

[1]Section 10(b), 15 U.S.C. § 78j(b), provides that:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> • • • • • • • • • • •
>
> (b) To use or employ, in conjunction with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the

tioned Securities Exchange Act of 1934 was premised on the assertion that a promissory note and deed of trust securing the note, both of which were issued by the Bellahs, and a certificate of deposit, subsequently issued by the Bank, were securities. Disagreeing with this assertion, the district court dismissed the complaint with prejudice for lack of jurisdiction of the subject matter. We affirm except to the extent that dismissal was with prejudice as to the alleged claim based on the certificate of deposit.

I

This suit had its inception in a 1963 loan by the Bank to the Bellahs to aid them in the development of a livestock business. Continuing misfortunes left the indebtedness unliquidated, and hence on March 20, 1967, the Bellahs executed a six-month promissory note, secured by a deed of trust on real property in favor of the Bank, for the principal sum of $259,121.82. This note renewed all prior credit extended to them. The ancillary deed of trust conveyed 17 tracts of their

Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

17 C.F.R. § 240.10b-5 stipulates that:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

real property as collateral, inferior to prior liens on the real estate. This combined obligation was subsequently twice renewed.

The most recent renewal is the subject of the instant litigation. On January 29, 1969, the Bellahs executed a promissory note of six-months maturity, collateralized by a deed of trust. They allege in their complaint that the Bank made several misrepresentations concomitant with the execution of the note, *inter alia*, that the Bellahs need not worry about foreclosure as long as the prior and superior deeds of trust were kept current. This misrepresentation purportedly induced them to forego the initiation of federal bankruptcy reorganization proceedings. In December of 1969, they also arranged for $50,000 to be deposited in the Bank, through the First Mortgage Company of Houston, in exchange for which a certificate of deposit was issued. The Bellahs claim that this transaction was negotiated upon the agreement by the Bank that an equivalent amount would be loaned to them for the purpose of financing and recycling cattle. This latter exchange, allegedly effected to raise the capital structure of the Bank and thereby enable it to make the additional $50,000 loan, never materialized. Moreover, the Bellahs' delinquency on the January 12, 1969 note prompted the Bank to foreclose and sell the real estate covered by the deed of trust.

The complaint asserted three potential bases for finding subject matter jurisdiction: (1) the note; (2) the deed of trust; and (3) the certificate of deposit. In a truncated opinion, the district court elected to

treat the note and ancillary deed of trust as one, and held that irrespective of whether the note and deed of trust were commercial or investment in nature, they fell within the exemption of notes maturing in less than 9 months. *See* 15 U.S.C. § 78c(a)(10). The court failed to address the contention that the certificate of deposit was a security.[2]

II

It is in this posture that the case is before us on appeal. The district court correctly considered the note and accompanying deed of trust collectively as one potential basis of jurisdiction. Indeed, if the note were not characterizable as a security, it is difficult to conceive of how the deed of trust which secured it could be so characterized. Accordingly, we proceed to consider whether the note and deed of trust or the certificate of deposit are securities.

A. *Note and Deed of Trust*

The definitional section of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (1970) provides that unless the context otherwise requires:

> "(10) The term 'security' means any note . . . but shall not include . . . any note . . . which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace,

[2] A review of the complaint filed by the Bellahs suggests that this omission was readily understandable. The first four paragraphs of the complaint refer only to the note and deed of trust transactions. Paragraph five catalogues twelve alleged fraudulent inducements, the last of which revolved around the certificate of deposit transaction. Thus, it is only through a benevolent reading that the complaint could be deemed to posit the certificate of deposit as a predicate for subject matter jurisdiction.

> or any renewal thereof the maturity of which is likewise limited."

Depsite the seemingly absolute mandate of this language, numerous other courts have refused to ritualistically apply the section. *See* Zeller v. Bogue Electric Manufacturing Corp., 476 F.2d 795, 800 (2d Cir. 1973); Sanders v. John Nuveen & Co., Inc., 463 F.2d 1075, 1080 (7th Cir.), cert. denied, 409 U.S. 1009, 93 S.Ct. 443, 34 L.Ed.2d 302 (1972); SEC v. Vanco, Inc., 283 F.2d 304 (3d Cir. 1960), aff'g, 166 F.Supp. 422, 423 (D.N.J.1958); United States v. Hill, 298 F.Supp. 1221, 1226-1227 (D.Conn.1969); Anderson v. Francis I. duPont & Co., 291 F.Supp. 705, 708 (D.Minn. 1968); *cf.* United States v. Rachal, 473 F.2d 1338, 1343 (5th Cir. 1973). Rather, they have deemed notes with maturity dates not exceeding nine months to be subject to the Securities Exchange Act of 1934 where the notes constituted investment paper, not commercial paper. Illustrative of the reasoning underlying such dispositions is that expressed in Zeller v. Bogue Electric Manufacturing Corp., *supra* at 800:

> "[T]he mere fact that a note has a maturity of less than nine months does not take the case out of Rule 10b-5, unless the note fits the general notion of 'commercial paper' . . . It does not follow . . . that every transaction within the introductory clause of § 10, which involves promissory notes, whether of less or more than nine months maturity, is within Rule 10b-5. The Act is for the protection of investors, and its provisions must be read accordingly."

See also Sanders v. John Nuveen & Co., *supra* at 1080.

This reasoning gives due recognition to the Supreme Court's admonition in SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195, 84 S.Ct. 275, 285, 11 L.Ed.2d 237, 248 (1963) that anti-fraud securities legislation is to be read "not technically and restrictively, but flexibly to effectuate its remedial purposes" and is compatible with that expressed in SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 350-351, 64 S.Ct. 120, 123, 88 L.Ed. 88, 93 (1943) that:

> "However well these rules [of statutory construction] may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." (footnote omitted.)

And it is this reasoning which led us to approve in United States v. Rachal, 473 F.2d 1338, 1343 (5th Cir. 1973) an instruction given by a trial court which provided that the exemption of short-term notes from the registration provisions of the Securities Exchange Act of 1933 applied only to commercial not investment paper.[3] Since the '33 and '34 Acts, while not precisely

[3] The Securities Act of 1933 and the Securities Exchange Act of 1934 address the short-term commercial paper exemption in different fashions. As was indicated *supra*, the '34 Act provides for the exemption in its definitional section. *See* 15 U.S.C. § 78c(a) (1970). In contrast, the '33 Act, 15 U.S.C. § 77c(a) (1970) exempts short-term notes from the registration requirements set forth in 15 U.S.C. § 77e (1970), but not

the same, are virtually identical, *see* Zeller v. Bogue Electric Manufacturing Corp., *supra* at 799-800; Anderson v. Francis I. duPont & Co., *supra* at 708, we think that this court's approval of the instruction in *Rachal* portends our holding that the exemption for short-term paper under the Securities Exchange Act of 1934 applies only to commercial paper and not investment paper. To this extent, the district court's exclusive reliance on the maturity date of the note

from the Acts anti-fraud proscriptions. Section 77c(a) exempts:

> "(3) Any note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

The SEC has endeavored to explicate the requirements of this section in Securities Act Rel. No. 4412, 26 Fed.Reg. at 9159. This release provides that:

> "The legislative history of the Act makes clear that section 3(a)(3) applies only to prime quality negotiable paper of a type not ordinarily purchased by the general public, that is, paper used to facilitate well recognized types of current operational business requirements and of a type eligible for discounting by Federal Reserve banks."

This release, instructive as to the '34 Act's exemption for short-term notes, Zeller v. Bogue Electric Manufacturing Corp., *supra* at 800, has been construed to disqualify from characterization as commercial paper, a note issued by an individual or corporation in precarious financial condition. *See* Sanders v. John Nuveen & Co., Inc., *supra* at 1079; United States v. Hill, *supra* at 1227. In these two cases, suits were brought seeking to subject the makers of promissory notes to the Securities Exchange Act of 1934. In contrast, in this case, the maker of a promissory note seeks to invoke the Act's prophylactic protection. While we do not disparage the conclusions reached in *Hill and Sanders*, we do suggest that a maker cannot bring the notes he executes within the Act merely by demonstrating his own lack of fiscal integrity. While the investment-commercial dichotomy is not intractable, it is not as chameleon-like as the Bellahs' contention would render it.

was misplaced.[4]

The disposition of this appeal hence ultimately hinges upon whether the note executed by the Bellahs can be characterized as commercial or investment in nature. In this vein, McClure v. First National Bank of Lubbock, 352 F.Supp. 454 (N.D.Tex.1973), appeal pending, No. 73-1376; Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973); and Sanders v. John Nuveen & Co., *supra*, are particularly instructive.[5]

In McClure v. First National Bank of Lubbock, *supra* Juanita McClure, a one-half owner of common stock in and Secretary of Gaines City Development (GCD), was allegedly induced by the First National Bank of Lubbock and her former husband who was president of GCD to execute a $200,000 note from GCD to the bank supposedly to liquidate the corporation's bad debts. This note was secured by a deed of trust which mortgaged to the bank a parcel of land which constituted substantially all the assets of the

[4] The Bellahs proffered the argument that the promissory note which formed the basis for this 10b-5 action should not be viewed in isolation from the prior notes, the obligations of which it renewed. Were a ritualistic application of the short-term note exemption to be countenanced, the purposes of the Act could be easily undermined by short-term notes issued and then renewed over a protracted time period. However, our conclusion that the exemption applies only to commercial paper warrants pretermission of the Bellahs' contention.

[5] The commercial-investment dichotomy is also addressed in Zeller v. Bogue Electric Manufacturing Corp., *supra;* City National Bank v. Vanderboom, 290 F.Supp. 592 (W.D.Ark 1968), aff'd, 422 F.2d 221 (8th Cir.), cert. denied, 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d 560 (1970); SEC v. Fifth Avenue Coach Lines, Inc., 289 F.Supp. 3 (S.D.N.Y. 1968), aff'd on other grounds, 435 F.2d 510 (2d Cir. 1970); Davis v. Avco Corp., 371 F.Supp. 782, 787 (N.D.Ohio 1974); SEC v. Thunderbird Valley, Inc., 356 F.Supp. 184 (D.S.Dakota 1973); Joseph v. Norman's Health Club, Inc., 336 F.Supp. 307 (E.D.Missouri 1971).

corporation. Further inquiry revealed that the proceeds of this loan were actually applied in payment of her former husband's debt to the bank and not in payment of corporate obligations. Moreover, several years later, McClure executed a separate collateral agreement, pledging to the bank a portion of all her own stock for the purpose of securing a new note which would renew and extend the original note issued by GCD. GCD's delinquency in fulfilling these obligations prompted the bank to institute foreclosure proceedings, pursuant to which all its real estate was sold to the bank.

The district court held that jurisdiction of the subject matter was lacking. Characterizing the alleged transactions as involving no more than mere internal corporate mismanagement, 352 F.Supp. at 458, it concluded that "the transactions involved amount to little more than ordinary commercial loans not intended to be covered by the Act. These transactions are totally unrelated to the abuses involving 'trading for speculation or investment,' which abuses Congress in 1934 sought to eliminate." 352 F.Supp. at 457-458.

Lino v. City Investing Co., *supra*, and Sanders v. John Nuveen & Co., *supra*, employ reasoning similar to that adopted in *McClure*. In *Lino*, a 10b-5 action was instituted by a purchaser of a franchise sales center license for which promissory notes had been issued to the franchiser in partial payment. The Third Circuit characterized the notes as commercial and not investment in nature because it defied logic to assume that City Investing Co. purchased Lino's note and gave

as payment, a right to operate a franchise sales center. And in *Sanders*, the Seventh Circuit expressed its view that "[w]hen a prospective borrower approaches a bank for a loan and gives his note in consideration for it, the bank has purchased commercial paper." 463 F.2d at 1080 (dicta).

We think that the reasoning articulated in these cases is compelling, and supports the conclusion that the note issued by the Bellahs in this case was commercial paper and not investment paper. The record reveals that in extending the loans, the Bank merely intended to aid the Bellahs in the operation of their livestock business. It is bereft of any evidence indicating that the Bank sought to profit from the successful operation of this enterprise. This court's previous remonstrations that under the Act, almost all notes are securities, *see* Rekant v. Desser, 425 F.2d 872, 878 (5th Cir. 1970); Lehigh Valley Trust Co. v. Central Bank of Jacksonville, 409 F.2d 989, 991-992 (5th Cir. 1969), imply that some notes are not. We merely hold that notes issued in the context of a commercial loan transaction fall beyond the purview of the Act.

Our disposition is buttressed by a recognition of the unsalutary consequences that would be generated by a contrary result. First, in view of the previously acknowledged similitude of the '33 and '34 Acts, notes subject to the anti-fraud proscriptions of the latter would be amenable to the registration provisions of the former. Registration is a costly procedure, both temporally and financially speaking. Subjection of loan

transactions involving a promissory note to the registration requirements would inevitably wreak havoc on the commercial paper market. We have grave doubts that such a result was sought by Congress. Second, the Securities Act of 1933 and the Securities Exchange Act of 1934 create for participants in note transactions a broad but nevertheless not boundless federal forum for vindicating their grievances. We doubt that Congress intended by these Acts to render federal judges the guardians of all beguiled makers or payees. Where, as here, complaints are spawned by a commercial loan transaction, recourse must be had to state not federal courts. Mindful of these policy considerations and the reasoning employed by courts in adumbrating the commercial-investment dichotomy, we reject the Bellahs' claim that the note and the ancillary deed of trust are securities.

B. *Certificate of Deposit*

Section 78c(a)(10) of the Securities Exchange Act of 1934 includes as a security a "certificate of deposit, for a security." Under the judicial gloss placed on this language, a certificate of deposit issued in exchange for currency is not encompassed within the section because currency is not a security. Superintendent of Insurance of State of New York v. Banker's Life & Casualty Co., 300 F.Supp. 1083, 1099 (S.D.N.Y.1969), aff'd, 430 F.2d 355 (2d Cir. 1970), rev'd on other grounds, 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971); SEC v. Fifth Avenue Coach Lines, Inc., 289 F.Supp. 3, 31 (S.D.N.Y.1968) aff'd on other grounds, 435 F.2d 510 (2d Cir. 1970). To the extent that the

Bellahs rely on a contrary proposition, their argument is thus unavailing.

We confess, however, that we have endeavored in vain to divine the precise theory upon which their contention is bottomed.[6] Despite a scrutinizing examination of the record and the briefs on appeal, and attempts to elicit guidance from counsel at oral argument, we have been able to ascertain only that the Bellahs invoke as support for their position two cases, Superintendent of Insurance of State of New York v. Banker's Life & Casualty Co., 300 F.Supp. 1083 (S.D.N.Y.1969), and Young v. Seaboard Corp., 360 F. Supp. 490 (D.Utah 1973). The understandable failure of the district court to address the certificate of deposit issue compounds the difficulty posed by the nebulous argument presented on appeal. Nevertheless, notwithstanding these impediments to review, we undertake to explore the applicability of the aforementioned decisions to the instant case.

Clearly, Superintendent of Insurance of State of New York v. Banker's Life & Casualty Co., 300 F. Supp. 1083 (S.D.N.Y. 1969) provides no comfort.

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[6]Counsel for the Bank assumed that the Bellahs were contending that the certificate of deposit transaction was an investment contract. This assumption was reasonable in view of the Bellahs' reference in their brief to Safeway Portland Employees Credit Union v. C. H. Wagner & Co., 335 F.Supp. 116 (D.Or. 1971). This case involved a scheme wherein defendant Wagner & Company solicited purchases of certificates of deposit issued by a bank, holding out as an inducement to purchase, Wagner & Company's promise to pay ½% interest at maturity. The purchases of the certificates of deposit enabled the bank to make loans to substandard borrowers who would pay Wagner & Company a broker's fee. Because of the investment nature of the scheme, the court held that an investment contract existed. Again, the investment character is lacking in the instant case.

This much is manifest by the fact that the district court expressly refrained from reaching the question of whether certificates of deposit issued in order to conceal the depletion of Manhattan Casualty Company's assets by Banker's Life & Casualty Company and two individual defendants were securities. *See* 300 F.Supp. at 1099. Moreover, the district court intimated in dicta that the certificates of deposit could not qualify under the Securities Exchange Act of 1934 either as evidences of indebtedness or as notes. *See* 300 F.Supp. at 1100.

Young v. Seaboard Corp., 360 F.Supp. 490 (D.Utah 1973) is of similar inutility. There, shareholders of the now defunct National Bank of Coalville, instituted a section 10b-5 action, claiming that the Seaboard Corporation (Seaboard) had fraudulently precipitated the demise of the bank. Seaboard allegedly caused one million dollars to be deposited in the bank in exchange for certificates of deposit and payment of an illegal finder's fee. The deposits and finder's fees prompted the bank to make at least $450,000 in bad loans, purportedly to Seaboard's designees.

The reasoning employed in treating these deposit and loan transactions as purchases or sales of securities is somewhat obtuse.[7] The court appears to have

[7]We quote, in full, the district court's analysis:

> "In the opinion of the court, under plaintiffs' claim both the deposit transactions and the loan transactions would be purchases or sales of securities within the meaning of section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10), section 10(b) of that act and rule 10b-5. *As to certificates of deposit, see:* Tcherepnin v. Knight, 389 U.S. 332, 344, 88 S.Ct. 548, 19 L.Ed.2d 564 (1967); Bromberg, Securities Law, *supra*, § 4.6(312), (373). *But see* S.E.C. v. Fifth Avenue Coach Lines, Inc. 289 F.Supp. 3,

relied on two theories. First, the certificates of deposit could be characterized as short-term promissory notes under Zeller v. Bogue Electric Manufacturing Corp., *supra*. But, as we noted earlier, *Zeller* endorsed the investment-commercial dichotomy which we countenanced and then applied adversely to the Bellahs' contentions. In support of the second theory to which it attached no appellation, the district court cited Tcherepnin v. Knight, 389 U.S. 332, 88 S.Ct. 548, 19 L.Ed. 2d 564 (1967) where the Supreme Court held that withdrawable capital shares in an Illinois Savings & Loan Association, City Savings Association of Chicago, could qualify as security under the '34 Act. In reaching this conclusion, the Supreme Court had observed that shareholders were dependent on the skill and efforts of City Savings in making sound loans because Illinois law tied the payment of dividends on withdrawable capital shares to an apportionment of the profits. *See* 389 U.S. at 338-339, 88 S.Ct. at 554, 19 L.Ed.2d at 570. And throughout the opinion, the Court emphasized the investment character of the

38 (S.D.N.Y. 1968) (dictum), aff'd 435 F.2d 510 (2nd Cir. 1970), questioned in Zeller v. Bogue Electric Manufacturing Corp., *supra* at 93,621 [cite to CCH] ("[t]he district court opinion contains dicta with which we would not agree, see 289 F.Supp. 3, 38 [S.D.N.Y. 1968]"). *As to short term promissory notes, see:* Zeller v. Bogue Electric Manufacturing Corp., *supra;* Sanders v. John Nuveen & Co., 463 F.2d 1075 (7th Cir.), cert. denied, 409 U.S. 1009, 93 S.Ct. 443, 34 L.Ed.2d 302 (1972); Bromberg, Securities Law, *supra* § 4.6(371). *But see* S.E.C. v. Fifth Avenue Coach Lines Inc., *supra*, 289 F.Supp. at 38 (dictum). *questioned in* Zeller v. Bogue Electric Manufacturing Corp., *supra* at 93,621; L. Loss, 1 Securities Regulation 546 (1969)" (footnotes omitted).

360 F.Supp. at 495-496.

scheme.[8] Again, it is this characteristic which we have repeatedly found absent in the transactions between the First National Bank of Hereford and the Bellahs. Accordingly, we fail to discern how Young v. Seaboard Corp., *supra*, adds force to the Bellahs' contention. Thus, on the basis of the arguments presented on this appeal, we conclude that the certificate of deposit is not a security.

III

To reiterate, we hold that the note and ancillary deed of trust executed by the Bellahs to the Bank is commercial and not investment paper and hence is not embraced by the Securities Exchange Act of 1934. We also conclude that the argument pressed upon us with respect to the certificate of deposit is similarly inefficacious. To this extent, the district court's order is affirmed.

We do not believe, however, that the Bellahs' complaint should be dismissed with prejudice in its entirety. Although not through any fault of the district court, it would appear that the Bellahs may not have

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[8] The court in Tcherepnin v. Knight, supra, relied extensively upon SEC v. W. J. Howey Co., 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946) and SEC v. C. M. Joiner Leasing Corp, 320 US. 344, 64 S.Ct. 120, 88 L.Ed 88 (1943). The definition of an investment contract, formulated in *Howey*, emphasizes the investment nature of an enterprise. The Court stated that "[t]he test is whether the scheme involves an *investment* of money in a common enterprise with *profits* to come solely from the efforts of others." SEC v. W. J. Howey & Co., 328 U.S. at 301, 66 S.Ct. at 1104, 90 L.Ed. at 1251 (Emphasis added). And in SEC v. C. M. Joiner Leasing Corp., 320 U.S. at 351, 64 S.Ct. at 120, 88 LEd at 93, the Court defined the reach of the Securities Act of 1933 "to include by name or description many documents in which there is common trading for *speculation* or *investment*." (emphasis added).

had a plenary opportunity to ventilate their claims concerning the certificate of deposit. The arguments which have been presented on appeal have been categorically rejected. And because of the essential commercial nature of the transactions between the Bellahs and the Bank, we are skeptical of the possibility that any additional light which could be shed on this matter would warrant a conclusion contrary to that which we have reached. Nevertheless, lest their rights be forsaken in any respect by the limited review of their certificate of deposit contention, we shall not foreclose them from an opportunity to pursue that theory of liability in the district court, if they are able and inclined to do so. Accordingly, we affirm the dismissal of the complaint, except to the extent that the dismissal was with prejudice as to the certificate of deposit. In all other respects the judgment of the district court is affirmed.

Modified and affirmed.

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

CIVIL ACTION NO. CA-4-1798

JUANITA McCLURE

Plaintiff

VS.

THE FIRST NATIONAL BANK OF
LUBBOCK, TEXAS, ET AL

Defendant

COMPLAINT

TO THE HONORABLE JUDGE
OF SAID COURT:

JUANITA McCLURE, Plaintiff, complains of the Defendants named hereinafter, and would respectfully show the following:

I.

The Plaintiff is a resident of Lubbock, Lubbock County, Texas. Defendant, THE FIRST NATIONAL BANK OF LUBBOCK, is a banking corporation with its principal place of business in the First National Bank Building, Lubbock, Lubbock County, Texas, upon which service of process may be had by serving its President or other officer. Defendant, STERLING EMENS, JR., at the time his conduct hereinafter complained of occurred, was a resident of Lubbock County, Texas, but is now a resident of Harris County, Texas,

and may be served with citation at his residence, 13119 Paradise Valley, Houston, Texas. Defendant, ADOLPH R. HANSLIK, is a resident of Lubbock County, Texas, where he may be found for service of process. Defendant, GAINES COUNTY DEVELOPMENTS, is a Texas corporation, upon which service may be had by serving Adolph R. Hanslik, its registered agent for service of process.

II.

The Court has jurisdiction of this suit by virtue of the provisions of Title 15, Sub-chapter 78a through 78u, U.S.C.A. (Securities Exchange Act of 1934), Chapter 404, Section 1, 48 Statutes, 881.

III.

Plaintiff brings this suit both individually and upon behalf of Gaines County Developments, a Texas corporation, which is made party Defendant because it is controlled by the individual Defendants who, being guilty of the acts of omissions hereinafter complained of, would not permit it to become a Party Plaintiff to this action.

IV.

At one time, Plaintiff and Defendant Hanslik were married, and they were divorced by Judgment entered on July 25, 1964. In such divorce judgment, the trial court therein approved a property settlement agreement between Plaintiff and Defendant Hanslik, a true copy of which is attached to this petition marked Exhibit "A," and made a part hereto by reference

the same as if stated in full at this point. [Such exhibit not included in this Appendix]

By the terms of such property settlement agreement between Plaintiff and Defendant Hanslik, each retained ownership of one-half (½) of the common stock of certain corporations, including Gaines County Developments, a Texas corporation. At all times pertinent hereto, Defendant Hanslik was President, or general manager, or directed the affairs of Gaines County Developments, without consultation with his other shareholder, Plaintiff herein, and Hanslik in effect exercised control over the business operations of such corporation without complying with his fiduciary duties owed to Plaintiff, and as hereinafter set forth.

V.

A. On or about August 15, 1964, Defendant Hanslik represented to Plaintiff, in Lubbock, Texas, or her attorneys, or both of them, that Gaines County Developments, a corporation, needed to borrow $200,000.00 from Defendant First National Bank of Lubbock, for said corporation's business debts, a substantial portion of which such Defendants alleged were owed by such corporation to such bank. Defendant Sterling Emens, Jr., was at such time, and remained until on or about August 31, 1967, a vice president and loan officer of the First National Bank of Lubbock, and said Defendant Emens also represented to Plaintiff or her attorneys that such $200,000.00 loan was needed for the corporation,

Gaines County Developments, for its business purposes.

B. Acting in reliance on such representations, Plaintiff, who was inexperienced in financial and business matters, upon the request of Defendants Hanslik and Emens, executed in Lubbock, Texas, a promissory note as Secretary of Gaines County Developments, and Defendant Hanslik executed such note as President, dated on or about August 15, 1964, payable to the order of Defendant First National Bank. On such date the corporation, purportedly acting through Plaintiff and Defendant Hanslik, also executed and delivered to A. Doyle Justice, trustee, for the benefit of Defendant Bank, a Deed of Trust to secure payment of such note, which Deed of Trust mortgaged to the Defendant Bank approximately 2,833 acres of such corporation's land in Gaines County, Texas, which acreage was substantially all of the assets of said corporation. Such transaction was consummated on or about September 4, 1964, when the Defendant bank caused to be deposited in said bank, in Lubbock, Texas, to the account of Gaines County Developments, a corporation, said $200,000.00 pursuant to such note which by its terms that it was due and payable on or before August 13, 1965.

C. However, by reason of fraud and conspiracy between Defendant Hanslik and Defendant Emens, such $200,000.00, or a substantial part of it, was not intended by Defendants Hanslik and Emens to, and was not by Hanslik applied to, business debts of Gaines County Developments. Rather, it was applied

to, with the full fraudulent and conspiratorial knowledge of Defendants Hanslik and Emens to payment of a pre-existing separate and individual liability of Defendant Hanslik to the Defendant Bank, arising out of the following circumstances:

1. On or about August 3, 1964, at a time when he already owed the First National Bank approximately $700,675.00, Defendant Hanslik, with the approval and consent of Defendant Emens, who was the Defendant Bank's loan officer servicing Defendant Hanslik's private business accounts, borrowed from the Bank the sum of $200,000.00, payment for which was unsecured. As stated above, the $200,000.00 borrowed by Gaines County Developments, a corporation, from the Defendant Bank, was not deposited in the corporation's account at the Defendant Bank until September 4, 1964. On that same date, September 4, 1964, Defendant Hanslik, with the $200,000.00 belonging to Gaines County Developments, borrowed from the Defendant Bank, paid off his pre-existing $200,000.00 indebtedness owed to the Defendant First National Bank of Lubbock, again with the fraudulent and conspiratorial knowledge and consent of Defendant Emens acting as vice president and/or loan officer of the Defendant Bank. Under date September 3, 1964, Defendant Hanslik, without any knowledge thereof being given to Plaintiff, executed his promissory note in the amount of $200,000.00 payable to the order of Gaines County Developments and applied the $200,000.00 of the corporate funds for his and the Defendant Bank's private benefit. Plaintiff did not discover the existence of such note until the last day

of July 1969, or early August 1969, and she could not have discovered it before in the exercise of reasonable diligence under the circumstances. A true copy of such note discovered by Plaintiff is attached hereto and marked Exhibit "B" for reference. [Such exhibit is not included in this appendix]

VI.

Defendants, or Defendant Hanslik, with the knowledge, consent or connivance of Defendant Bank, acting by and through Defendant Emens in the scope of his employment, promised Plaintiff that the corporation's $200,000.00 note to the Defendant Bank was to be used only for payment of necessary corporate debts, which said promise none of Defendants intended to keep. Such promise was an inducement to Plaintiff's participation in the transactions, and to her signing the instruments which she signed relating to such transactions.

VII.

A. On or about April 4, 1967, Plaintiff executed a purported separate collateral agreement pledging to the First National Bank of Lubbock 18,750 shares of her common stock in Gaines County Developments and 5,000 shares of her common stock in Gaines Farm and Ranch Corporation for the purpose of securing a new note renewing and extending the original note of $200,000.00 made by Gaines County Developments. A new Deed of Trust was executed and recorded in Volume 196, page 35, of the Deed Records of Gaines County, Texas. The purported renewal note dated

April 4, 1967, was in the original principal sum of $202,300.16. On or about September 3, 1968, after the Defendant Bank instituted foreclosure proceedings, A. Doyle Justice, trustee under such Deed of Trust, purportedly sold all of the Gaines County property of Gaines County Developments, a corporation, to the First National Bank for $125,000.00. Such instruments are securities, as are the note and Deed of Trust executed by Gaines County Developments to the order of Defendant Bank in 1964, and also the 1964 note executed by Hanslik for $200,000.00 to such corporation.

B. Each Defendant, by the use of any means or instrumentality of interstate commerce or of the mails, directly or indirectly, employed or used, in connection with the purchase or sale of a security, a manipulative or deceptive device or contrivance, in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 adopted thereunder.

VIII.

Plaintiff was damaged by said Defendants' conduct and false and illegal misrepresentations concerning the purpose for which the Gaines County Developments' promissory note in the amount of $200,000.00 made about August 1964 was executed and delivered to the Defendant Bank. Such damage is the sum at least $264,500.00, being Plaintiff's interest in the value of the collateral given to secure the 1964 note for $200,000.00 at the time it was mortgaged to the Defendant Bank, plus interest thereon at the rate of

six percent (6%) per annum, from about August 15, 1964, until paid.

IX.

A. Plaintiff alleges upon information and belief that the fair market value of the land situated in Gaines County, Texas, made the subject of the 1964 Deed of Trust, and any renewals of it, at the time the $200,000.00 transaction was consummated between the Bank and Gaines County Developments in 1964, was at least $397,000.00. In addition, in consummation of the scheme between the Defendants above described, Gaines County Developments also assigned to the Defendant Bank, as additional security for payment of such $200,000.00 note, vendor's lien notes held by such corporation in the value and amount of at least $132,000.00, and thus the Bank received security of the value of at least $529,000.00. The bank is thus liable to Gaines County Developments, a corporation, for said $529,000.00, plus interest thereon from on or about August 15, 1964.

B. Hanslik, as its principal managing officer and director, defrauded Gaines County Developments by causing it to issue securities for the private personal purposes of Defendant Hanslik, and against the best interests of the corporation, to the Defendant Bank, in league with Defendant Emens and the Defendant Bank, acting in pursuit of the scheme to obtain for the Bank the valuable properties of Gaines County Developments as collateral for payment of a note owed to the Bank which was in effect for the separate business indebtedness of Defendant Hanslik.

X.

Such conduct by Defendants was attended by circumstances showing such a wanton or willful or wreckless disregard of Plaintiff's rights as to entitle Plaintiff to recover exemplary damages from them, jointly and severally, in the sum of at least $100,000.00.

XI.

To protect her property rights herein, Plaintiff has had to employ Simon & Simon, attorneys at law, of Fort Worth, Texas, duly licensed and practicing members of the State Bar of Texas, and of this federal bar, and has agreed to pay them a reasonable attorneys' fees for such services, which such sum in the Northern District of Texas, is at least $7,000.00.

XII.

Defendant, Adolph Rudolph Hanslik, has been adjudicated as a bankrupt in bankruptcy proceeding No. BK-5-387, in the United States District Court for the Northern District of Texas, Lubbock Division, and by order dated April 26, 1971, the Honorable Frank R. Murray, Referee in Bankruptcy, issued his Order of Discharge of said Bankrupt. Accordingly, although Plaintiff wishes to pursue the relief requested in this Complaint against Defendant Hanslik individually, Plaintiff should not do so until it has been conclusively determined that Defendant Hanslik individually, has been discharged by such bankruptcy proceedings of the liability herein alleged. Plaintiff is thus requesting the District Clerk to prepare, but not to deliver to

the United States Marshal for service, any citation or service of process concerning Adolph R. Hanslik, individually, in this matter, until prior approval therefor is obtained from the Referee in Bankruptcy.

WHEREFORE, Plaintiff prays that the Defendants, each of them (except Adolph R. Hanslik, individually) be cited to appear and answer this Complaint, and that upon hearing hereof, Plaintiff recover damages, as alleged above, both actual and exemplary, and for her costs and attorneys' fees, as above alleged, and for such other and further relief, general or special, at law or in equity, to which she may show herself entitled.

Respectfully submitted,
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By /s/ Harold D. Hammett
HAROLD D. HAMETT
Attorneys for Plaintiff

APPENDIX F

Securities Exchange Act of 1934, 15 U.S.C. § 3(a):

(4) The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.

(5) The term "dealer" means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security;" or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

(13) The terms "buy" and "purchase" each include

any contract to buy, purchase, or otherwise acquire.

(14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

Section 10(b), 15 U.S.C. § 78j:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 29(c), 15 U.S.C. § 78cc(c):

(c) Nothing in this chapter shall be construed (1) to affect the validity of any loan or extension of credit (or any extension or renewal thereof) made or of any lien created prior or subsequent to June 6, 1934, unless at the time of the making of such loan or extension of credit (or extension or renewal thereof) or the creating of such lien, the person making such loan or extension of credit (or extension or renewal thereof) or acquiring such lien shall have actual knowledge of facts by reason of which the making of such loan or extension of credit (or extension or renewal thereof) or the acquisition of such lien is a violation of the provisions of this chapter or any rule or regulation thereunder, or (2) to afford a defense to the collection of

any debt or obligation or the enforcement of any lien by any person who shall have acquired such debt, obligation, or lien in good faith for value and without actual knowledge of the violation of any provision of this chapter or any rule or regulation thereunder affecting the legality of such debt, obligation, or lien. June 6, 1934, c. 404, § 29, 48 Stat. 903; June 25, 1938, c. 677, § 3, 52 Stat. 1076.

SEC Rule 10b-5; 17 C.F.R. 240.10b-5

It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.